No. 88-412-CFX
Status: GRANTED

Title: Martin W. Hoffman, Trustee, Petitioner
v.
Connecticut Department of Income Maintenance, et al.

Docketed:
September 7, 1988

Court: United States Court of Appeals
for the Second Circuit

Counsel for petitioner: Hoffman,Martin W.

Counsel for respondent: Schuman,Carl J., Solicitor General

Entry	Date	Note	Proceedings and Orders
1	Sep 7 1988	G	Petition for writ of certiorari filed.
3	Sep 29 1988		Order ~~extending~~ time to file response to petition until November 7, 1988.
4	Oct 6 1988		Brief of respondent CT Dept. of Income Maintenance in opposition filed.
5	Nov 4 1988		Order further extending time to file response to petition until December 7, 1988.
6	Dec 7 1988		DISTRIBUTED. January 6, 1989
7	Dec 7 1988	X	Brief of respondent United States filed.
8	Jan 9 1989		Petition GRANTED.
			**********
9	Feb 21 1989		Joint appendix filed.
10	Feb 21 1989		Brief of petitioners Connecticut Dept. of Income Maintenance, et al. filed.
11	Feb 23 1989	G	Motion of INSLAW, Inc. for leave to file a brief as amicus curiae filed.
12	Mar 6 1989		Motion of INSLAW, Inc. for leave to file a brief as amicus curiae GRANTED.
19	Mar 6 1989	G	Motion of the Acting Solicitor General for divided argument filed.
13	Mar 8 1989		SET FOR ARGUMENT, APRIL 19, 1989. (3rd CASE)
14	Mar 23 1989		Brief of respondents Connecticut, et al. filed.
15	Mar 24 1989		Brief amicus curiae of Arizona filed.
16	Mar 24 1989		Brief of respondent United States filed.
17	Mar 24 1989		Brief amici curiae of Illinois, et al. filed.
18	Mar 29 1989		CIRCULATED.
20	Apr 3 1989		Motion of the Acting Solicitor General for divided argument GRANTED.
21	Apr 14 1989		Record filed.
		*	Certified copy of original record and proceedings received.
22	Apr 19 1989		ARGUED.

88-412

No. ^ ^

Supreme Court, U.S.
FILED
SEP 7 1988
JOSEPH F. SPANIOL, JR.
CLERK

In The
Supreme Court Of The United States

OCTOBER TERM, 1988

IN RE WILLINGTON CONVALESCENT HOME, INC., DEBTOR

MARTIN W. HOFFMAN, TRUSTEE
Petitioner

v.

STATE OF CONNECTICUT, DEPARTMENT OF INCOME MAINTENANCE,

STATE OF CONNECTICUT, DEPARTMENT OF HEALTH SERVICES

and

UNITED STATES OF AMERICA
Respondents

IN RE EDWARD ZERA, DEBTOR

MARTIN W. HOFFMAN, TRUSTEE
Petitioner

v.

STATE OF CONNECTICUT, DEPARTMENT OF REVENUE SERVICES

and

UNITED STATES OF AMERICA
Respondents

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI WITH APPENDIX

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QUESTIONS PRESENTED FOR REVIEW

I. Whether 11 U.S.C. §106(c) authorizes a trustee in bankruptcy to recover a money judgment against a State when the State has not voluntarily waived sovereign immunity.

II. Whether Congress, in enacting 11 U.S.C. §106(c), 28 U.S.C. §§157(a) and 1334(b), abrogated a State's Eleventh Amendment immunity to suit in federal court by a trustee in bankruptcy.

PARTIES BELOW

Parties before the United States Court of Appeals for the Second Circuit in In re Willington Convalescent Home, Inc., were Martin W. Hoffman, Trustee, as Plaintiff-Appellant, State of Connecticut, Department of Income Maintenance and State of Connecticut, Department of Health Services as Defendant-Appellees and the United States of America as Intervenor-Appellee.

The parties before the United States Court of Appeals for the Second Circuit in In re Zera were Martin W. Hoffman, Trustee, as Plaintiff-Appellant, State of Connecticut, Department of Revenue

Services, as Defendant-Appellee and the United States of America as Intervenor-Appellee.

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NO._____

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1988

MARTIN W. HOFFMAN, TRUSTEE

Petitioner,

vs

STATE OF CONNECTICUT,
DEPARTMENT OF INCOME MAINTENANCE,

STATE OF CONNECTICUT,
DEPARTMENT OF HEALTH SERVICES

AND

UNITED STATES OF AMERICA

Respondents

IN RE EDWARD ZERA, DEBTOR

MARTIN W. HOFFMAN, TRUSTEE

Petitioner

vs

STATE OF CONNECTICUT,
DEPARTMENT OF REVENUE SERVICES

AND

UNITED STATES OF AMERICA

Respondents

On Petition for Writ of Certiorari
to
the United States Court of Appeals
for the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit, not yet reported, appears in the appendix hereto.

The opinion of the United States District Court for the District of Connecticut in In re Willington Convalescent Home, Inc. is reported at 72 B.R. 1002 (D.Conn. 1987) and appears in the appendix hereto. The opinion of said Court in In re Edward Zera is reported at 72 B.R. 997 (D.Conn. 1987)

and appears in the appendix hereto.

The opinion of the United States Bankruptcy Court of the District of Connecticut in In re Willington Convalescent Home, Inc. is reported at 39 B.R. 781 (Bankr. D. Conn. 1984) and appears in the appendix hereto. The opinion of said Court in In re Edward Zera is unreported and appears in the appendix hereto.

JURISDICTIONAL STATEMENT

Petitioner, Martin W. Hoffman, Trustee, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United

States Court of Appeals for the Second Circuit entered in this proceeding on June 15, 1988. This Court has jurisdiction to review said judgment and opinion by writ of certiorari under 28 U.S.C. §1254(1).

CONSTITUTIONAL PROVISIONS

The full text of the Eleventh Amendment to the United States Constitution is set forth in the appendix hereto.

STATUTORY PROVISIONS

The full text of the following statutory provisions is set forth in the appendix hereto:

11 U.S.C. §101(26)
11 U.S.C. §106
11 U.S.C. §542
11 U.S.C. §547(b)
11 U.S.C. §550
28 U.S.C. §157(a)
28 U.S.C. §1334(b)

STATEMENT OF THE CASE

In re Willington Convalescent Home, Inc., Debtor No. 2-82-00508, and In re Edward Zera, 2-83-00754, are unrelated Chapter 7 cases presently pending in the United States Bankruptcy Court for the District of Connecticut (hereinafter "Bankruptcy Court"). The Petitioner herein, Martin W. Hoffman, Trustee, is the trustee in bankruptcy appointed in each of said Chapter 7 cases.

Willington Convalescent Home,

Inc., (hereinafter "Willington"), which operated a nursing home, filed its voluntary petition under Chapter 11 of the Bankruptcy Code (hereinafter "Code"), Title 11 of the U.S. Code, on June 2, 1982. Prior to filing its Chapter 11 petition, Willington had contracted with the State of Connecticut to provide services to eligible patients under the Medicaid Program. Under the contract Willington was reimbursed its costs of caring for eligible patients by the State of Connecticut at a per diem rate, determined from costs reports submitted by Willington.

Willington operated its business as a debtor-in-possession during the

pendency of its Chapter 11 case. On July 27, 1983, the Chapter 11 case was converted to a Chapter 7 case on Willington's motion and the Petitioner was appointed as trustee.

In September, 1983, the Petitioner made demand on the State of Connecticut, Department of Income Maintenance (who, together with the State of Connecticut, Department of Health Services, is collectively referred to hereinafter as the "State"), for unpaid Medicaid cost reimbursements in the amount of $64,010.24. These unpaid cost reimbursements were for services rendered by Willington to eligible Medicaid patients during the Chapter 11

case, in particular, during March, 1983. The State refused to pay the cost reimbursements, claiming the right to recoup alleged past Medicaid overpayments made to Willington prior to the commencement of the Chapter 11 case from the amounts due to Willington as debtor-in-possession for services performed during the Chapter 11 case. Although the State claims that there is still outstanding the amount of $121,408.00 in alleged pre-petition overpayments, the State has not filed a proof of claim in the case.

On January 3, 1984, the Petitioner commenced an adversary proceeding in the Bankruptcy Court to recover from the State the $64,010.25 in unpaid cost

reimbursements as a debt due to the Estate, pursuant to 11 U.S.C. §542(b). On February 3, 1984, the State moved to dismiss the Petitioner's adversary proceeding on the grounds of sovereign immunity and that the State had the right to recoup pre-petition Medicaid overpayments under the aforesaid contract. On April 25, 1984, the Bankruptcy Court denied the State's motion to dismiss. On May 25, 1984, the State appealed the Bankruptcy Court's decision to the District Court.

In Zera, the debtor, Edward Zera, did business as Alyear Maintenance Services. Prior to filing bankruptcy, he was indebted to the State of Connecticut, Department of Revenue

Services, (hereinafter "Revenue Services"), in the amount of $1,977.00 for unpaid sales and use taxes, penalties and interest. On or about September 22, 1983, Revenue Services issued a tax warrant pursuant to Conn. Gen. Stat. §12-35 for the total unpaid taxes, penalties, interest and fees. The tax warrant was served by an officer on Pioneer Systems as garnishee. On October 6, 1983, Pioneer Systems paid the $1,977.00 in total unpaid taxes, penalties and interest and the $123.62 service fee due the officer, for a total of $2,100.62.

On October 7, 1983, Zera filed a voluntary petition under Chapter 7 of the Code and the Petitioner was appointed as trustee.

On January 4, 1984, the Petitioner commenced an adversary proceeding in the Bankruptcy Court against Revenue Services, to avoid the aforesaid garnishment pursuant to 11 U.S.C. §547(b) as a preferential transfer and to recover the funds pursuant to 11 U.S.C. §550(a). On February 21, 1984, Revenue Services moved the Bankruptcy Court to dismiss the Petitioner's adversary proceeding on the grounds of sovereign immunity. The Bankruptcy Court denied the motion in a Memorandum and Order dated June 8, 1984. On June 15, 1984, Revenue Services appealed the Bankruptcy Court's decision to the District Court.

Because the appeals in both

Willington Convalescent Home, Inc. and Edward Zera raised a question concerning a state's Eleventh Amendment immunity, the District Court, on June 18, 1985, apprised the Attorney General of the United States of the constitutional question in both cases pursuant to 28 U.S.C. §2403(b). In both cases the United States moved to intervene, which motions were granted by the District Court, and filed a brief.

On May 8, 1987, the District Court entered a Judgment and issued a Memorandum of Decision in Willington Convalescent Home, Inc. and entered an Order and issued a Memorandum of Decision in Edward Zera. In both cases

the District Court reversed the Bankruptcy Court and dismissed the Petitioner's adversary proceedings. On June 4, 1987, the Petitioner appealed the decisions of the District Court in both appeals to the United States Court of Appeals for the Second Circuit, (hereinafter "Court of Appeals"). On June 15, 1988, the Court of Appeals decided both cases, affirming the decision of the District Court in each.

REASONS FOR GRANTING THE WRIT

This Court should grant the Petitioner's petition for writ of certiorari in these cases for the following reasons. First, the Second Circuit's decision in In re Willington

Convalescent Home, Inc., Nos. 87-5021, 87-5023 (2nd Cir. June 15, 1987), is in direct conflict with the decision, on the same matters, of the United States Court of Appeals for the Seventh Circuit (hereinafter "Seventh Circuit") in the Matter of McVey Trucking, Inc., 812 F.2d 311 (7th Cir. 1987). Second, the Second Circuit's decision in this case that 11 U.S.C. §106(c) does not abrogate a state's Eleventh Amendment immunity to suit for money damages in the federal courts conflicts with the recent decisions of this Court concerning Congressional abrogation of Eleventh Amendment immunity.

In Willington Convalescent Home, Inc., the Second Circuit addressed two

issues. The first was whether 11 U.S.C. §106(c) waived a state's sovereign immunity and authorized the Petitioner, a trustee in bankrutpcy, to recover money judgments against the State of Connecticut based upon 11 U.S.C. §542(b) and 11 U.S.C. §§547(b) and 550(a). The second issue was whether, in enacting 11 U.S.C. §106(c), Congress abrogated the State of Connecticut's Eleventh Amendment immunity to a suit by the Petitioner in the bankruptcy court to recover a money judgment against it.

With respect to the first issue, the Second Circuit decided that the language of 11 U.S.C. §106(c) did not authorize suits against a state to

recover money damages. The language of the statute, the Second Circuit stated, waived state sovereign immunity only to the extent necessary for the bankruptcy court to determine a state's rights in the debtor's estate and not to the extent of allowing a trustee to recover a money judgment against the state. In re Willington Convalescent Home, Inc., slip op. at 4087. This interpretation of the statutory language was, according to the Second Circuit, supported by the statute's legislative history. Id. at 4089.

-With respect to the second issue, the Second Circuit stated that 11 U.S.C. §106(c) was not an unmistakeably clear statement by Congress of an

intention to abrogate a state's Eleventh Amendment immunity to a suit in the federal courts to recover a money judgment against the state. Id. at 4091. Thus, the Second Circuit concluded that Congress did not intend to waive a state's Eleventh Amendment immunity and to authorize suits for money damages against a state when it enacted 11 U.S.C. §106(c). Id. at 4091. These holdings by the Second Circuit are in conflict with the decision of the Seventh Circuit on the same issues in the McVey Trucking, Inc. case.

In McVey Trucking, Inc., the Chapter 11 debtor-in-possession sought to recover certain transfers made

to the State of Illinois both prior to and after the filing of the debtor-in-possession's Chapter 11 petition. McVey Trucking, Inc., 812 F.2d at 313-14. The debtor-in-possession brought a lawsuit against the State of Illinois, Secretary of State, claiming that the transfers were preferential and, therefore, recoverable under 11 U.S.C. §547(b)[1]. Id. at 313, 314. The State of Illinois moved to dismiss the

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[1] Although the Seventh Circuit's opinion speaks of the debtor-in-possession recovering the preferential transfers under 11 U.S.C. §547(b), that section of the Bankruptcy Code only makes such transfers avoidable. See 11 U.S.C. §547(b) (West, 1988). Recovery of the property transferred or its value by the trustee or debtor-in-possession is authorized by 11 U.S.C. §550(a). See 11 U.S.C. §§550(a) (West, 1988).

lawsuit on the grounds of Eleventh Amendment immunity. Id. at 313. The Seventh Circuit reversed the District Court's affirmance of the Bankruptcy Court's dismissal of the debtor-in-possession's suit. Id. at 313.

In reversing the District Court, the Seventh Circuit held that the language of 11 U.S.C. §§106(c) and 547(b) made clear Congress' intent to create a cause of action for money damages enforceable against a state in federal court. Id. at 326. The Seventh Circuit, unlike the Second Circuit, focused its reasoning on whether 11 U.S.C. §547(b) permitted the debtor-in-possession to recover a money

judgment against a creditor, entity or governmental unit. Id. at 326. The Seventh Circuit found that 11 U.S.C. §547(b) permitted the recovery of a money judgment against a "creditor", therefore, pursuant to the language of 11 U.S.C. §106(c), a state is bound by a money judgment entered in a suit brought against it under 11 U.S.C. §547(b). Id. at 326. Support for this interpretation of the statute was found by the Seventh Circuit in the legislative history of 11 U.S.C. §106(c). Id. at 327.

The bulk of the Seventh Circuit's opinion, however, concerned the issue of whether Congress, in enacting 11 U.S.C. §106(c), abrogated the states'

Eleventh Amendment immunity to suit in the federal courts. In a lengthy, thorough and well reasoned analysis of the decisions of this Court on the issue, the Seventh Circuit arrived at the conclusion directly opposite to that of the Second Circuit in Willington Convalescent Home, Inc. The Seventh Circuit held that, in light of the language of 11 U.S.C. §§101(26), 106(c) and 547(b) and the legislative history, it was certain that Congress intended to abrogate a state's Eleventh Amendment immunity to a suit under 11 U.S.C. §547(b) to recover money damages. Id. at 327. Unlike the Seventh Circuit, the Second Circuit, in reaching the opposite conclusion, analyzed only the language of 11 U.S.C.

§106(c) without also analyzing those provisions of the Bankruptcy Code, in particular 11 U.S.C. §§542(b), 547(b) and 550(a), to which 11 U.S.C. §106(c) relates. Thus, the Second Circuit did not account for the fact that the language of 11 U.S.C. §106(c) provides that states are bound by determinations by the bankruptcy court of issues arising under sections of the Bankruptcy Code, such as 11 U.S.C. §§542(b), 547(b) and 550(a), that provide for recovery of money judgments against "entities". See 11 U.S.C. §§106(c), 542(b) and 550(a) (West 1988).

It is this decision by the Second Circuit on the issue of whether

Congress waived the Eleventh Amendment immunity of the states in enacting 11 U.S.C. §106(c) that provides the second reason for this Court to grant this petition for writ of certiorari. The Second Circuit's holding that the language of 11 U.S.C. §106(c) does not express a clear intent by Congress to subject the states to causes of action under the Bankruptcy Code to recover money judgments conflicts with this Court's decision on a similar issue in Fitzpatrick v. Bitzer, 427 U.S. 445, 96 S. Ct. 2666, 49 L.Ed. 2d 614 (1976). The issue in the Fitzpatrick case was whether Congress waived the state's Eleventh Amendment immunity to suits in the federal courts for money damages brought by an individual pursuant to

the 1972 Amendments to Title VII of the Civil Rights Act of 1964. Id., 427 U.S. at 448. This Court held that Congress had the power to waive Eleventh Amendment immunity when enacting legislation pursuant to the plenary legislative authority granted to it in Section 5 of the Fourteenth Amendment and that the language of the pertinent statutes, as amended in 1972, clearly expressed Congressional intent to do so. Id., 427 U.S. at 452, 456. The statutes in issue, 42 U.S.C. §2000e, et seq., provided a cause of action to an individual for damages caused by an employer who engages in an unlawful employment practice. Id., at 427 U.S. at 447-48. The term "employer", as used in the statutes, was defined so as

to include a state. Id., 427 U.S. at 449 & n.2. Thus, Congressional authorization to sue a state as an employer for money damage was clearly present. Id., 427 U.S. at 452.

The statutory provisions addressed in Fitzpatrick are very similar to the Bankruptcy Code provisions at issue in Willington Convalescent Home, Inc., as pertains to Congressional waiver of Eleventh Amendment immunity. Section 106(c) of the Bankruptcy Code provides:

> (c) Except as provided in subsections (a) and (b) of this section and notwithstanding any assertion of sovereign immunity--
> (1) a provision of this title that contains "creditor", "entity" or governmental unit" applies to governmental units; and
> (2) a determination by the court of an issue arising under such a provision binds governmental units.

11 U.S.C. §106(c) (West 1988). The term governmental unit is defined in 11 U.S.C. §101(26) (formerly 11 U.S.C. §101(20)), as, inter alia, a state or department, agency or instrumentality of a state. See 11 U.S.C. §101(26) (West 1988).

Among the provisions of the Bankruptcy Code made applicable to governmental units under section 106(c)(1) are sections 542(b), 547(b) and 550(a). Each of these three sections contains one of the trigger terms, "creditor", "entity" or "governmental unit", which makes it applicable to a state. Section 542(b), by its terms, gives a trustee, such as the Petitioner, a cause of action to

recover a money judgment against an entity on a debt that is property of the estate. See Matter of Kakolewski, 29 B.R. 572, 574 (Bankr. W.D. Mo. 1983); 11 U.S.C. §542(b) (West 1988). Section 547(b) permits a trustee to avoid certain pre-petition transfers to or for the benefit of creditors as preferential transfers. See Federal Deposit Ins. Corp. v. Davis, 733, F.2d 1083 (4th Cir. 1984); 4 Collier on Bankruptcy, Para. 547.01, pp. 547-6-547-7 (15th ed. 1987); 11 U.S.C. §547(b) (West 1988). Section 550(a) permits the trustee, after a transfer is avoided under 11 U.S.C. §547, to recover the property transferred or its value from the entity for whose benefit the transfer was made. See In re Roco

Corp., 701 F.2d 978, (1st Cir. 1983); 4 Collier on Bankruptcy, Para. 550.02, pp. 550-4-550-6 (15th ed. 1985); 11 U.S.C. §550(a) (West 1988). Jurisdiction over an action brought by the trustee under 11 U.S.C. §542(b), 547(a) and 550(a) rests in the Bankruptcy Court pursuant to 28 U.S.C. §§1334(b) and 157(a)[2]. These statutes provide, respectively, that the district courts have original but not exclusive jurisdiction over adversary proceedings and that the

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2 At the time the adversary proceedings in Willington Convalescent Home, Inc. were commenced by the Petitioner, jurisdiction in the Bankruptcy Court was predicated upon the emergency resolution adopted by the United States District Judges for the District of Connecticut. See Willington Convalescent Home, Inc., slip op. at 408 n.4.

district courts may refer such adversary proceedings to the bankruptcy courts. See 28 U.S.C. §§1334(b) and 157(a). (West 1988). When sections 106(c), 542(b), 547(b) and 550(a) of the Bankruptcy Code are read together in light of the jurisdictional provisions of 28 U.S.C. §§1334(b) and 157(a), Congress' intent to waive Eleventh Amendment immunity and authorize the recovery of money judgments against states under these sections of the Bankruptcy Code is unmistakeably clear. Thus, the Second Circuit's decision in Willington Convalescent Home, Inc. is in conflict with this Court's decision in Fitzpatrick.

Conclusion:

For the foregoing reasons, the Petitioner prays that this Court grant certiorari.

Respectfully Submitted,

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APPENDIX TO PETITION FOR A WRIT OF CERTIORARI

APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 481, 482—August Term, 1987

(Argued January 27, 1988 Decided June 15, 1988)

Docket Nos. 87-5021, 87-5023

IN RE: WILLINGTON CONVALESCENT HOME, INC.,

Debtor.

MARTIN W. HOFFMAN, TRUSTEE,

Plaintiff-Appellant,

—against—

STATE OF CONNECTICUT, DEPARTMENT OF INCOME MAINTENANCE AND STATE OF CONNECTICUT, DEPARTMENT OF HEALTH SERVICES,

Defendants-Appellees,

UNITED STATES OF AMERICA,

Intervenor-Appellee.

IN RE: EDWARD ZERA,

Debtor.

MARTIN W. HOFFMAN, TRUSTEE,

Plaintiff-Appellant,

—against—

STATE OF CONNECTICUT,
DEPARTMENT OF REVENUE SERVICES,

Defendant-Appellee,

UNITED STATES OF AMERICA,

Intervenor-Appellee.

Before:

OAKES, NEWMAN and MINER,
Circuit Judges.

Appeals from judgments entered in the United States District Court for the District of Connecticut (Dorsey, J.), reversing orders of the United States Bankruptcy Court for the District of Connecticut (Krechevsky, J.) that had allowed trustee's suits against the state to recover a matured debt and to avoid a preferential payment.

Affirmed.

MARTIN W. HOFFMAN, Trustee, Hartford, CT, in both cases *for Plaintiff-Appellant*.

KENNETH A. GRAHAM, Assistant Connecticut State Attorney General, Hartford, CT (Joseph I. Lieberman, Connecticut State Attorney General, Hartford, CT, of counsel) *for Defendants-Appellees* State of Connecticut, Department ot Income Maintenance and Department of Health Services.

CARL J. SCHULMAN, Assistant Connecticut State Attorney General, Hartford, CT (Joseph I. Lieberman, Connecticut State Attorney General, Jonathan L. Ensign, Assistant Connecticut State Attorney General, Hartford, CT, of counsel) *for Defendant-Appellee* State of Connecticut, Department of Revenue Services.

TRACY J. WHITAKER, Attorney, United States Justice Department, Washington, DC (Richard K. Willard, Assistant United States Attorney General, J. Christopher Kohn, Attorney, United States Justice Department, Washington, DC, Stanley A. Twardy, Jr., United States Attorney for the District of Connecticut, Hartford, CT, of counsel) in both cases *for Intervenor-Appellee*.

MINER, *Circuit Judge*:

Plaintiff-appellant Martin W. Hoffman, as trustee for Willington Convalescent Home, Inc. and for Edward Zera in two separate and unrelated Chapter 7 proceedings under the Bankruptcy Code, 11 U.S.C. § 101 *et seq.* (1982 & Supp. IV 1986) ("the Code"), commenced adversarial proceedings in the United States Bankruptcy Court for the District of Connecticut (Krechevsky, J.) against defendants-appellees State of Connecticut *et al.* ("Connecticut" or "the state"). The separate complaints sought to recover $64,010.24 for Willington's services under Connecticut's Medicaid Program and to avoid and recover as a preference $2,100.62 collected in back state sales and use taxes owed by Zera. The bankruptcy court allowed the actions over Connecticut's assertion of immunity from suit in the federal courts under the eleventh amendment of the United States Constitution, finding that Congress had abrogated the state's immunity from these actions in § 106 of the Code, 11 U.S.C. § 106(c).[1] On appeal to the United

1 Section 106 provides in full:

(a) A governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which such governmental unit's claim arose.

(b) There shall be offset against an allowed claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.

(c) Except as provided in subsections (a) and (b) of this section and notwithstanding any assertion of sovereign immunity—

(1) a provision of this title that contains "creditor", "entity", or "governmental unit" applies to governmental units; and

(2) a determination by the court of an issue arising under such a provision binds governmental units.

States District Court for the District of Connecticut (Dorsey, J.), the court reversed the bankruptcy court and ordered that the trustee's suits be dismissed as barred by the eleventh amendment. The trustee appeals from these judgments. We affirm.

BACKGROUND

Willington Convalescent Home, Inc. ("Willington"), a nursing home operator, contracted with the State of Connecticut under its Medicaid Program to admit Medicaid eligible patients at a per diem rate, which the state determined from cost reports that Willington submitted. After Medicaid payments are made, the Connecticut Department of Income Maintenance conducts field audits of the costs claimed and may adjust retroactively a facility's per diem rate and deduct past Medicaid payments, for costs improperly claimed, from present Medicaid payments for current services, *see* Conn. Agencies Regs. 17-311-53. A field audit of Willington in late 1980 revealed that its claims of $294,007.00 in real property costs were allowable only to the extent of $22,500.00 and that Willington had received Medicaid overpayments for five years. Accordingly, the state revised Willington's per diem rates and began recouping the past overpayments from current payments to Willington. Willington made a timely request for review of the adjustment as to three of the years pursuant to Conn. Gen. Stat. § 17-311. Subsequently, however, Willington moved to postpone indefinitely a hearing on its request.

In 1982, Willington filed for Chapter 11 bankruptcy, but continued operation and participation in the Medicaid program until it closed in April 1983. Willington at no time submitted its Medicaid contract with the state to the

bankruptcy court for assumption or rejection. Although Willington still owed $121,408.00 at its closing, the state filed no proof of claim.

After Willington's case was converted to Chapter 7 in July 1983, appellant Hoffman was appointed trustee and commenced an adversarial action—in essence, a turnover proceeding under § 542(b)[2]—against the state to recover $64,010.24 for Willington's Medicaid services during March 1983. The state admitted that Willington had rendered these services, but asserted sovereign immunity from the trustee's suit as well as the right to recoup overpayments.

Likewise, Hoffman brought an adversarial proceeding against the Connecticut Revenue Department as trustee in the Chapter 7 case of Edward Zera. Zera owed the state overdue sales and use taxes, a renewal fee and penalties

2 We reject Connecticut's contention that the action in *Willington* was a "related" proceeding for past contractual money damages, and not a § 542(b) proceeding. The section provides in pertinent part that "an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee," 11 U.S.C. § 542(b). The trustee sought to "recover a money judgment . . . for services sold and delivered on account" in "the amount of $64,010.24," Appendix for Willington at 6 (trustee's complaint). Connecticut concedes that Willington rendered the services, but claims that it has a recoupment right which subsumes the entire payment due Willington. *See* 39 Bankr. at 783. The trustee's complaint, however, "clearly alleges" that Connecticut "owe[s] a matured debt that is property of the estate," *In re Rawson*, 40 Bankr. 167, 169 (Bankr. N.D. Ohio 1984). Although "actions on account and debt and contract generally arise under state law," § 542(b) "sufficient[ly] . . . arrogate[s] the general law concepts and transform[s] them into bankruptcy law," *Matter of Kakolewski*, 29 Bankr. 572, 574 (Bankr. W.D. Mo. 1983) (footnote omitted). "The mere fact that" Connecticut denies that it owes the matured debt for Willington's services because of a recoupment right "does not take the trustee's action outside the scope of section 542(b)," *Rawson*, 40 Bankr. at 169.

and interest in connection with a business he owned. In September 1983, the Revenue Department issued a tax warrant, which resulted in payment of $2,100.62 to the state.

Zera filed for bankruptcy on October 7, 1983, and Hoffman filed a complaint on January 5, 1984 seeking to avoid the $2,100.62 payment as a preference, *see* 11 U.S.C. § 547(b),[3] and to recover the monies transferred to the state, *see id.* § 550(a). The state asserted both sovereign and eleventh amendment immunities from suit, and moved to dismiss the action.

In each case, the bankruptcy court denied Connecticut's motion to dismiss. *See Matter of Willington Convalescent Home, Inc.*, 39 Bankr. 781, 792 (Bankr. D. Conn. 1987);

3 Section 547(b) provides:

Except as provided in subsection (c) of this section, the trustee may avoid any transfer of property of the debtor—

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made—

(A) on or within 90 days before the date of the filing of the petition; or

(B) between 90 days and one year before the date of the filing of the petition, if such creditor, at the time of such transfer—

(i) was an insider; and

(ii) had reasonable cause to believe the debtor was insolvent at the time of such transfer;

and

(5) that enables such creditor to receive more than such creditor would receive if—

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

Matter of Zera, No. 2-83-00754, slip op. at 14 (Bankr. D. Conn. June 8, 1984). Judge Krechevsky concluded that Congress had intended § 106(c) to abrogate the state's eleventh amendment immunity from suit under 11 U.S.C. §§ 542(b), *see Willington*, 39 Bankr. at 786-88, and 547(b), *see Zera*, slip op. at 11-14, and had authorized federal courts to hear such suits pursuant to 28 U.S.C. § 1471(b), the Code's former jurisdictional section,[4] *Willington*, 39 Bankr. at 789; *Zera*, slip op. at 10-11. The bankruptcy court found that the Bankruptcy Clause, U.S. Const., art. I, § 8, cl. 4, empowered Congress to do so. *See Willington*, 39 Bankr. at 789-91; *Zera*, slip op. at 11.

The state appealed from both decisions to the United States District Court for the District of Connecticut. The United States successfully moved to intervene to present argument on the constitutionality of § 106. On appeal, the district court rejected the bankruptcy judge's interpretation of § 106(c) and therefore did not reach the constitutional issue. *See In re Willington Convalescent Home, Inc.*, 72 Bankr. 1002, 1012 (D. Conn. 1987); *In re Zera*, 72 Bankr. 997, 1002 (D. Conn. 1987). Judge Dorsey found that the bankruptcy court's analysis was "premised on a construction of § 106(c) which cannot readily be harmonized with subsections (a) and (b)," *Willington*, 72 Bankr.

4 Because § 1471(c) gave the bankruptcy courts "all of the jurisdiction conferred by this section on the district courts," the Supreme Court declared § 1471 an unconstitutional delegation to the article I bankruptcy courts of powers reserved to article III courts. *See Northern Pipeline Constr. Co. v. Marathon Pipeline Co.*, 458 U.S. 50 (1982). In 1984, Congress enacted 28 U.S.C. §§ 157 and 1334 to replace § 1471. In the meantime, during which the *Willington* and *Zera* adversarial proceedings were commenced, "[a]n emergency resolution adopted by the United States District Judges for the District of Connecticut temporarily restored the bankruptcy court's" jurisdiction over civil proceedings "arising in or related to" title 11 cases, subject to "review and control by the district court," *Willington*, 72 Bankr. at 1007 n.12.

at 1007. He emphasized that § 106(c) should not be read in isolation from subsections (a) and (b), *id*. Furthermore, the district court reasoned, since subsections (a) and (b) provide for limited state exposure to compulsory or permissive counterclaims after it has filed a proof of claim against the estate, a broad reading of subsection (c), "permit[ting] suits against the state for retroactive money damages irrespective of whether the state had" filed a proof of claim, would render subsections (a) and (b) "mere surplusage." *Id*. Judge Dorsey noted that alleged waivers of sovereign immunity "must be strictly construed in favor of the sovereign," *id*. at 1008, and the court must be " 'certain' " that " 'an unequivocal expression' " of Congress' intent to waive the states' immunity is " 'in the statute itself,' " *id*. Reviewing "the language and legislative history [of § 106] . . . as well as the better reasoned case law," the district court held that § 106(c) was a limited waiver of sovereign immunity that "did not authorize a suit for retrospective money damages against the State of Connecticut," *id*. at 1012. "Because it is not 'certain' that Congress provided a cause of action against a state" for retrospective monetary relief under § 542(b), *id*., or § 547(b), *see Zera*, 72 Bankr. at 1002, the bankruptcy court had no jurisdiction in either case to adjudicate the trustee suits. Accordingly, the bankruptcy court's orders were reversed, *see Willington*, 72 Bankr. at 1012; *Zera*, 72 Bankr. at 1002. The trustee's action was dismissed in *Willington*, 72 Bankr. at 1012, and in *Zera* was remanded to the bankruptcy court for dismissal, 72 Bankr. at 1002.

On appeal, trustee Hoffman argues that the bankruptcy court properly held that Congress intended § 106(c) to waive state sovereign and eleventh amendment immunities from suit under §§ 542(b) and 547(b). We agree with the district court that the waiver of immunity under § 106(c)

extends neither to turnover proceedings under § 542(b) nor to actions for the recovery of funds after a preferential transfer is avoided under § 547(b). We therefore affirm in both cases.

DISCUSSION

The resolution of this appeal turns on how Congress intended § 106(c) to affect a state's eleventh amendment immunity from suit in federal court. "[T]he starting point for interpreting a statute is the language of the statute itself," *Consumer Prod. Safety Comm'n v. GTE Sylvania*, 447 U.S. 102, 108 (1980), and statutory provisions must be construed as a whole, not in isolation, *see, e.g., United States v. Morton*, 467 U.S. 822, 828 (1984). "We may also examine the statute's legislative history to ensure that the meaning we have ascribed to . . . [its] words fits" the legislative purpose. *Pompano v. Michael Schiavone & Sons, Inc.*, 680 F.2d 911, 913 (2d Cir.), *cert. denied*, 459 U.S. 1039 (1982). Accordingly, we look not only to the language of § 106(c), but also to that of § 106(a) and (b), as well as to the legislative history of § 106, to determine whether subsection (c) waives a state's immunity from a turnover proceeding or recovery of an avoided preferential transfer.

1. *Language of § 106*

Section 106 addresses waiver of sovereign immunity by "governmental units" in bankruptcy cases. A governmental unit is defined to include the "United States; [s]tate; [or] [c]ommonwealth" or "department, agency or instrumentality" thereof. 11 U.S.C. § 101(26). Section 106(a) provides that "[a] governmental unit is deemed to have waived sovereign immunity with respect to any claim

against [it] . . . that is property of the estate and that arose out of the same transaction or occurrence out of which such governmental unit's claim arose." This subsection thus conditions the state's "receiv[ing] a distribution from the estate" upon waiver of immunity against *any* compulsory counterclaims asserted against it "without limit" in a bankruptcy proceeding. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 317 (1977), *reprinted in* 1978 U.S. Code Cong. & Admin. News 5963, 6274; S. Rep. No. 989, 95th Cong., 2d Sess. 29 (1978), *reprinted in* 1978 U.S. Code Cong. & Admin. News 5787, 5815. Accordingly, § 106(a) provides for "affirmative recovery," *see* H.R. Rep. No. 595, *supra*; S. Rep. No. 989, *supra*, including money judgments, *see In re Inslaw, Inc.*, 76 Bankr. 224, 234 (Bankr. D.D.C. 1987).

Section 106(b) allows "any claim against [a] governmental unit that is property of the estate" to be set off against a governmental unit's "allowed claim or interest." The debtor thus has a right to a setoff against a governmental unit "to the extent of" that unit's claim against the estate, *see* H.R. Rep. No. 595, *supra*; S. Rep. No. 989, *supra*. Moreover, the "allowed claim" language has been construed as incorporating § 502(a)'s rule that "[a] claim or interest, proof of which is *filed* under section 501 of this title, is deemed *allowed*" (emphasis added). *See, e.g., In re Davis*, 20 Bankr. 519, 521 (Bankr. M.D. Ga. 1982). Thus, § 106(b) is not triggered unless the governmental unit has asserted a claim against the estate.

Section 106(c) provides that:

> Except as provided in subsections (a) and (b) of this section and notwithstanding any assertion of sovereign immunity—

(1) a provision of this title that contains "creditor", "entity", or "governmental unit" applies to governmental units; and

(2) a determination by the court of an issue arising under such a provision binds governmental units.

The "Except as provided in" language that introduces this subsection unmistakably distinguishes it from subsections (a) and (b). Thus, while (a) and (b) are not triggered unless the government has asserted a claim against the debtor's estate, (c) has no such requirement. *Matter of Neavear*, 674 F.2d 1201, 1204 (7th Cir. 1982). Moreover, counterclaims and setoffs under (a) and (b) "may be bottomed on non-bankruptcy statutory or common law rights which could not otherwise form the basis for a law suit against the [g]overnment because of the sovereign immunity doctrine." *Matter of Community Hosp.*, 15 Bankr. 785, 789 (Bankr. S.D.N.Y. 1981). Subsection (c) relates only to issues that arise under "a provision of Title 11 . . . that contain[s] the word 'creditor' or the word 'entity' or the word 'governmental unit.' " *Davis*, 20 Bankr. at 522. The most important distinction, however, goes to the scope of these subsections. Both § 106(a) and (b) waive sovereign immunity as to "any *claim* asserted against such governmental unit" providing for affirmative monetary recoveries on counterclaims and for monetary recoveries within the confines of a setoff. However, § 106(c)(2) provides only that governmental units are *bound* by "a *determination* by the court of *an issue* arising under" a provision containing one of the "triggering" terms enumerated in subsection (c)(1), 11 U.S.C. § 106(c)(2) (emphasis added). Thus, the plain language of § 106(c)(1) and (2), particularly when read in light of § 106(a) and (b),[5] waives state sovereign immunity only to the extent necessary for the bankruptcy court to determine a state's rights in the debtor's estate.

2. *Legislative History of § 106*

The legislative history of § 106, although not extensive, supports this interpretation. As proposed in H.R. 8200 and S. 2266, § 106 provided only for the waivers now embodied in subsections (a) and (b). The House Report on H.R. 8200 stated that:

> Section 106 provides for a limited waiver of sovereign immunity in bankruptcy cases. Though Congress has the power to waive sovereign immunity for the Federal government completely in bankruptcy cases, the policy followed here is designed to achieve approximately the same result that would prevail outside of bankruptcy. Congress does not, however, have the power to waive sovereign immunity completely with respect to claims of [the] bankrupt estate against a [s]tate, though it may exercise its bank-

5 The district court relied in part on the argument that the bankruptcy court's reading of § 106(c) rendered subsections (a) and (b) "mere surplusage," *see* 72 Bankr. at 1007-08 & n.13, 1011 (citing *In re Regal Constr. Co.*, 18 Bankr. 353 (Bankr. D. Md. 1982)). However, the bankruptcy court's interpretation leaves intact critical differences that preclude (a) and (b) from being considered surplusage. As observed in *Matter of Neavear*, 674 F.2d 1201 (7th Cir. 1982), § 106(c), "unlike sections 106(a) and (b), does not condition the waiver of sovereign immunity upon the filing of a proof of claim," *id.* at 1204. *See also Matter of McVey Trucking, Inc.*, 812 F.2d 311, 327 (7th Cir.) (rejecting surplusage argument on basis of *Neavear*), *cert. denied sub nom. Edgar v. McVey Trucking Co.*, 108 S. Ct. 227 (1987). Moreover, § 106(a) and (b) are not tied to any particular Code sections, while subsection (c) applies only to those Code provisions containing "creditor," "entity," or "governmental unit." We, therefore, do not rely upon the surplusage argument in our analysis.

> ruptcy power through the supremacy clause to prevent or p[r]ohibit [s]tate action that is contrary to bankruptcy policy.

H.R. No. 595, *supra*, at 317, *reprinted in* U.S. Code Cong. & Admin. News at 6274. Both bills "preserve[d] sovereign immunity for tax authorities by excepting government tax claims from the preference rules," S. Rep. No. 1106, 95th Cong., 2d Sess. 6 (1978); *see* H.R. Rep. No. 595, *supra*, at 373, *reprinted in* 1978 U.S. Code Cong. & Admin. News at 6329.

However, in the compromise bill which resulted from H.R. 8200 and S. 2266, the present subsection (c) was added. The floor statements explained that § 106(c) "codifies *In re Gwilliam*, 519 F.2d 407 (9th Cir.[ ] 1975) and *In re Dolard*, 519 F.2d 282 (9th Cir.[ ] 1975)" and "compl[ies] with the requirement in case law that an express waiver of sovereign immunity is required in order to be effective," 124 Cong. Rec. H11091 (daily ed. Sept. 28, 1978) (Rep. Edwards); *id.* S17407 (daily ed. Oct. 6, 1978) (Sen. DeConcini). In both *Gwilliam* and *Dolard*, the Internal Revenue Service ("IRS") asserted that the bankruptcy court had no jurisdiction to determine the amount or dischargeability of unpaid federal income taxes unless the IRS had filed a proof of claim. However, § 2(a)(2A), added to the Bankruptcy Act in 1966, provided that bankruptcy courts had jurisdiction to determine "the amount or legality of any unpaid tax." 11 U.S.C. § 11(a)(2A) (1966). Although the Senate Judiciary Committee Report pertaining to this provision stated that the addition to the Bankruptcy Act of § 2(a)(2A) did not change the requirement that a proof of claim be filed before the bankruptcy court exercises jurisdiction, *see* S. Rep. No. 999, 89th Cong., 2d Sess., *reprinted in* 1966 U.S. Code Cong. & Ad-

min. News 2442, 2452, the *Gwilliam* court concluded that this Report did "not speak the consensus of Congress" and was better ignored "rather than to injudiciously batter the expressed language of § 11(a)(2A) to a nullity," 519 F.2d at 410. Accordingly, the Ninth Circuit held that the bankruptcy court had jurisdiction to determine the amount and dischargeability of unpaid federal taxes accruing before bankruptcy, *id.* at 408, 410, or after bankruptcy, *Dolard*, 519 F.2d at 286, even if the IRS failed to file a proof of claim.

The primary purpose, then, behind 106(c) was to codify the results that the IRS thought were worth opposing in *Gwilliam* and *Dolard*. *See Neavear*, 674 F.2d at 1204. Although the floor statements to § 106(c) also make clear that its applicability "is not limited to those issues, but permits the bankruptcy court to *bind* governmental units on other matters as well," 124 Cong. Rec., *supra*, at H11091, S17407 (emphasis added), they do not indicate that the scope of the sovereign immunity waiver was intended to extend beyond *determinations* of the bankruptcy court. Instead, these legislative statements show that governmental units are bound not only by determinations involving the amount and dischargeability of tax claims, but also by determinations made under any Code section containing a triggering term.

3. *Eleventh Amendment Immunity*

The trustee here urges that § 106(c) *can* be read to authorize a suit to recover monies from a *state* under any Code provision containing a triggering term, regardless of the type of relief sought. Because §§ 542(b) and 547(b) both contain triggering terms and the bankruptcy court has jurisdiction of actions pursuant to them under 28 U.S.C. §§ 157(a) and 1334(b), the trustee contends that

Congress clearly abrogated a state's eleventh amendment immunity from such suits in federal court.[6] These arguments, however, fail to surmount the heavy burden of showing congressional waiver of eleventh amendment immunity from actions for money recoveries.

The eleventh amendment "limits the grant of judicial authority in Art[icle] III" of the Constitution, *Pennhurst State School & Hosp. v. Halderman*, 465 U.S. 89, 98 (1984), prohibiting the exercise of federal jurisdiction over a suit against an unconsenting state "for damages, past debts or retroactive relief of any type," 1 R. Rotunda, J. Nowak & J. Young, Treatise on Constitutional Law: Substance and Procedure, § 2.12, at 87 (1986), particularly claims that "involve[ ] the payment of public funds from the state treasury," *McClary v. O'Hare*, 786 F.2d 83, 89 (2d Cir. 1986); *see Quern v. Jordan*, 440 U.S. 332, 337 (1979); *Edelman v. Jordan*, 415 U.S. 651, 663 (1974). A waiver of this immunity will be found "only where stated 'by the most express language or by such overwhelming implications from the text as [will] leave no room for any other reasonable construction,' " *Edelman*, 415 U.S. at 673. "Congress [must] unequivocally express its intention to abrogate" eleventh amendment immunity, and will do

6 Although § 106 speaks only of "sovereign immunity," that term clearly encompasses eleventh amendment immunity to the extent that the governmental unit in question is a state. As Judge Krechevsky correctly observed:

> The term "sovereign immunity" embraces two distinct concepts—"*whether* [a State] may be sued," *Pennhurst State School & Hospital v. Halderman*, [465 U.S. 89, 100 (1985),] . . . or common-law sovereign immunity, *and* "*where* [a State] may be sued," *id.*, or constitutional sovereign immunity in the [e]leventh [a]mendment.

39 Bankr. at 788-89. Thus, if a bankruptcy court can make determinations that bind a state under § 106(c), to that extent the state's eleventh amendment immunity from suit in federal court has been waived by § 106(c).

so only "by making its intention unmistakably clear in the language of the statute," *Atascadero State Hospital v. Scanlon*, 473 U.S. 234, 242 (1985). Moreover, statutes that purport to waive immunity are construed strictly in the sovereign's favor. *See Gray v. Bell*, 712 F.2d 490, 508 (D.C. Cir. 1983) (citing *McMahon v. United States*, 342 U.S. 25, 27 (1951)), *cert. denied*, 465 U.S. 1100 (1984).

We do not believe that Congress intended to waive eleventh amendment immunity and to authorize suits for money damages against a state by enacting a provision that "binds" governmental units by bankruptcy court "determination[s]." Congress has in no way made "its intention unmistakably clear in the language of the statute" that states are subject to adversarial proceedings in bankruptcy that involve payment of state funds to the estate. *See Atascadero*, 473 U.S. at 246 (statutory authorization of suit in federal court against *any* federal fund recipient insufficient to waive state's eleventh amendment immunity). A few courts have interpreted § 106(c) to allow adversarial actions for money recoveries against states in bankruptcy courts in both turnover proceedings, *see In re Prime, Inc.*, 44 Bankr. 924, 927 (Bankr. W.D. Mo. 1984) (dicta); *see also In re Vazquez*, 788 F.2d 130, 133 (3d Cir. 1986) (action to recover debt collected in violation of § 524(a)), *cert. denied sub nom. Vazquez v. Pennsylvania Dep't of Public Welfare*, 107 S. Ct. 414 (1986); *but see In re Crum*, 20 Bankr. 160, 161 (Bankr. D. Idaho 1982); *In re Regal Constr. Co.*, 18 Bankr. 353, 358 (Bankr. D. Md. 1982); *In re Ramos*, 12 Bankr. 250 (Bankr. N.D. Ill. 1981), as well as in preference actions, *see Matter of McVey Trucking, Inc.*, 812 F.2d 311, 326-27 (7th Cir.), *cert. denied*, 108 S. Ct. 227 (1987); *In re T & D Mgt. Co.*, 40 Bankr. 781, 789-90 (Bankr. D. Utah 1984) (dicta). However, the decisions allowing such actions either do not ana-

lyze the issue under the Supreme Court's standards for finding a congressional waiver of eleventh amendment immunity or do not reflect an appreciation for the stringency of those standards. In sum, therefore, we find that turnover proceedings under § 542(b) and preference actions under § 547(b) seeking monetary recoveries from a state are outside the scope of § 106(c) and thus barred by the eleventh amendment.

The trustee, nevertheless, argues that congressional intent is clear that § 106(c) at least allows a state to be sued for recovery of a preferential monetary transfer that is avoided under § 547(b). He points to a passage from the floor statements, concerning the applicability of § 106(c) to other bankruptcy issues, which he asserts supports his argument: "For example, section 106(c) permits a trustee or debtor in possession to assert avoiding powers under title 11 against a governmental unit; contrary language in the House report to H.R. 8200 is thereby overruled," 124 Cong. Rec., *supra*, at H11091, S17407. This legislative history, however, does not establish that Congress had the clear and unequivocal intention to waive eleventh amendment immunity as to actions against states for recovery of preferential money transfers. Whatever questions this passage may raise about Congress' intention as to preference actions, we must resolve them against finding a waiver of state immunity from money recoveries where, as in § 106(c), Congress has not made "its intention unmistakably clear *in the language of the statute*," *Atascadero*, 473 U.S. at 242 (emphasis added).

CONCLUSION

Having considered the language and legislative history of § 106 in light of the strict standard applicable to claims of congressional waiver of state eleventh amendment immunity, we hold that § 106(c) does not allow for actions pursuant to § 542(b) or § 547(b) to recover monies from a state. Accordingly, we affirm the judgments of the district court.

MEMORANDUM OF DECISION
OF THE DISTRICT COURT
DISTRICT OF CONNECTICUT

(Dated May 8, 1988)

Civil No. H 84-636 (PCD)

UNITED STATES DISTRICT COURT
District of Connecticut

IN RE WILLINGTON CONVALESCENT HOME, INC., DEBTOR

STATE OF CONNECTICUT, DEPARTMENT OF INCOME MAINTENANCE AND STATE OF CONNECTICUT, DEPARTMENT OF HEALTH SERVICES

Defendant/Appellants

v.

MARTIN W. HOFFMAN, TRUSTEE

Plaintiff/Appellee

MEMORANDUM OF DECISION

This is an appeal from a decision

by the United States Bankruptcy Court (Krechevsky, J.) denying the State of Connecticut's motion to dismiss a claim against it brought by the trustee of a debtor in a converted Chapter 7 bankruptcy proceeding. See Hoffman v. State of Connecticut (In re Willington Convalescent Home, Inc.), 39 Bankr. 785 (Bankr. D. Conn. 1984). The State had alleged that no money was owed to the debtor and that it was immune from suit in federal court by virtue of the bankruptcy laws and the eleventh amendment.1/

1/ The eleventh amendment declares:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State or by Citizens or Subjects of any Foreign State.

At the outset, appellee trustee raises a threshold objection -- in the form of a motion to dismiss2/ -- as to the propriety of this appeal. Appellee argues that the denial of the original motion to dismiss by the bankruptcy court was interlocutory in nature and not a final order. Plaintiff/Appellee's Memorandum in Support of the Motion to Dismiss ("Appellee's Memorandum") at 2. See Collier on Bankruptcy § 3.03(3) (15th ed. 1984) ("The denial of a motion to dismiss, even when the motion is based

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2/ Appellants claim that the appropriate vehicle for appellee's objection is a statement in the appeal brief attacking the basis for jurisdiction and not a separate motion to dismiss. Appellants' Memorandum in Opposition to Appellee's Motion to Dismiss ("Appellant's Memorandum") at 9. For the reason set forth in note 7, infra, this issue will not be addressed.

on jurisdictional ground, does not ... terminate the action and the order is interlocutory."). Because the ruling was interlocutory, appellee contends that it is appealable only by leave of the district court, as prescribed by Bankruptcy Rule 8001(b)3/ and only after the filing of a motion for leave to appeal with the bankruptcy court clerk, as required by Bankruptcy Rule 8003(a).4/ Appellants concede they did

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3/ Rule 8001(b) provides: "An appeal from an interlocutory judgment, order or decree of a bankruptcy judge ... shall be taken by filing a notice of appeal ... accompanied by a motion for leave to appeal prepared in accordance with Rule 8003 ... .

4/ Rule 8003(a) provides:

> A motion for leave to appeal ... shall contain:
>
> (1) a statement of the facts necessary to an understanding of the questions to be presented by the appeal;

not file a motion for leave to appeal, but assert no need to do so on the ground that the ruling of the bankruptcy court was final, not interlocutory, and governed, therefore, by Bankruptcy Rule 8001(a),5/ which

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(2) a statement of those questions and of the relief sought;

(3) a statement of the reasons why an appeal should be granted; and

(4) a copy of the judgment, order, or decree complained of and of any opinion or memorandum relating thereto.

Within 10 days after service of the motion an adverse party may file with the clerk of the bankruptcy court an answer in opposition.

5/ Rule 8001(a) provides: "An appeal from a final judgment, order, or decree of a bankruptcy judge to a district court . . . shall be taken by filing a notice of appeal with the clerk of the bankruptcy court . . . ."

requires merely the filing of a notice of appeal.

Assuming, arguendo, that the ruling of the bankruptcy court was interlocutory, not final, it may still be appealable to this court even in the absence of a motion for leave to appeal. Rule 8003(c) provides:

> Appeal Improperly Taken Regarded as a Motion for Leave to Appeal. If a required motion for leave to appeal is not filed, but a notice of appeal is timely filed, the district court . . . may grant leave to appeal or direct that a motion for leave to appeal be filed. The district court . . . may also deny leave to appeal but in so doing shall consider the notice of appeal as a motion for leave to appeal . . . .

Thus, the Bankruptcy Rules do not focus on the technical distinctions between a motion for leave to appeal and a notice of appeal; indeed, they entrust to the

district court discretion to determine whether the questions resolved by the bankruptcy court are or are not appealable.6/

Although appellee takes the position that the issues sought to be appealed are not of such a character that they cannot await review folllowing final adjudication on the merits by the bankruptcy court, Appellee's Memorandum at 4-6, the legal and constitutional questions raised by

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6/ As explained in the Advisory Notes to Rule 8003:

> Subdivision (c) provides that if a party mistakenly believes the order appealed from is final and files only a notice of appeal, the appeal is not automatically dismissed. The district court . . . has the options to direct that a motion be filed, to decide exclusively on the papers already filed to grant leave to appeal, or to deny leave to appeal.

the State of Connecticut implicate the doctrine of sovereign immunity and challenge the propriety of any and all proceedings against the State in the bankruptcy court. Such matters are well to be resolved prior to subjecting the parties to extensive litigation on the merits lest all efforts be found, on appeal, to have been in vain. The delicate balance of our federal system should make federal courts reluctant to require states to defend lawsuits to their conclusion which, arguably, Congress or the Constitution has placed beyond the federal judicial power. Accordingly, appellee's motion to

dismiss this appeal is denied.1/

Background

Willington Convalescent Home, Inc. ("Willington") formerly operated a nursing home facility which participated in the Connecticut Medicaid Program. Under the program, Willington agreed to provide nursing care services to indigent patients eligible under Title XIX at a specific per diem rate of compensation. The State determined the per diem rate from annual cost reports submitted by Willington.

1/ The decision to hear the appeal renders it unnecessary to address whether the order of the bankruptcy court was interlocutory or final, or whether appellee's motion to dismiss was the appropriate vehicle to raise these procedural issues.

Initially, the State accepts at face value the cost data submitted by nursing homes such as Willington, but regulations provide for subsequent field audits to verify that the costs claimed are legitimate. If costs are found to have been improperly claimed, the State may adjust the per diem rate retroactive to the applicable rate year and recoup the amount of medicaid overpayment from whatever monthly payments may be due and owing to the facility for current patient care.2/ If the nursing home disputes the findings made in the field audit, it may seek an administrative hearing within the Department of Income Maintenance, Conn. Gen. Stat. §17-311,

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2/ Section 17-311-53 of the Regulations of Connecticut State Agencies provides, in part:

and then seek judicial review by appeal to the Connecticut Superior Court, Conn. Gen. Stat. §4-183.

> (b) Whenever the Commissioner of Income Maintenance renders a rate decision, whether based upon a field audit or otherwise, which decision results in the facility being indebted to the Department of Income Maintenance for past medicaid overpayments, the Department shall recoup said medicaid overpayments as soon as possible from the Department's monthly medicaid payments to the facility . . . .
>
> (c) In a recoupment situation, the Department of Income Maintenance shall determine a recoupment schedule of amounts to be recouped from the facility's monthly medicaid payments after consideration of the following factors:
>
> (1) the amount of the indebtedness;
>
> (2) the objective of completion of total recoupment of past medicaid overpayments as soon as possible;

Willington submitted cost reports for the years 1976-1978 which were relied on by the State in setting the per diem Medicaid rates for those years. However, a field audit completed on December 3, 1980, discovered that real property costs claimed as $294,007 were actually only allowable in the amount of $22,500. As a result, Willington had received substantial Medicaid overpayments for

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> (3) the cash flow of the facility; and
>
> (4) any other factors brought to the attention of the department by the facility relative to the provider's ability to function after recoupment.

five rate-years. On February 24, 1982, the State retroactivaly revised Willington's per diem rates for 1976 and 1980; on August 6, 1982, the rates for 1977-1979 were also adjusted downward. Willington timely requested review of the latter rate decision, but then moved to postpone the administrative hearing indefinitely. Willington

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(d) Whenever a facility has received past medicaid overpayments, the Department may recoup the amount of such medicaid overpayments from the monthly payments to the facility regardless of any intervening change in ownership.

did not appeal the rate decision of February 24, 1982.

On June 2, 1982, Willington filed a Chapter 11 petition in bankruptcy. Willington did not submit its provider agreement to the bankruptcy court for assumption or rejection. Since Willington continued as a provider participant in the Medicaid Program, the Department of Income Maintenance sought to and did recoup a modest amount of the past Medicaid overpayment from the monthly payments due Willington for on-going patient care. Willington shut down permanently in April 1983 still owing the State $121,408. At no time did Connecticut file a proof of claim against the bankrupt estate.

On July 27, 1983, the bankruptcy court converted the case to one under Chapter 7 and appointed a trustee. The trustee filed a complaint against Connecticut seeking payment of $64,010.24 for services provided to Medicaid patients by Willington during March 1983. The State admitted the rendering of the services, but asserted both its right to recoup the prepetition Medicaid overpayments and its insulation from suit on grounds of sovereign immunity and the eleventh amendment. Accordingly, the State moved to dismiss for lack of subject matter jurisdiction and failure to state a claim upon which relief can be granted, Fed. R. Civ. P. 12(b)(1) and

12(b)(6), as made applicable to bankruptcy proceedings by Bankruptcy Rule 7012(b). In denying that motion, the bankruptcy court held that: (1) Congress had intended to abrogate the sovereign immunity of a state where, as here, the state owed a matured debt to the bankrupt estate; (2) Congress intended to abrogate the eleventh amendment immunity of a state to suit in federal court in the circumstances at bar; (3) Congress has authority under the Bankruptcy Clause of the Constitution9/ to abrogate a state's eleventh amendment and sovereign

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9/ "The Congress shall have Power . . . to establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Const. Art. I, §8.

immunity; and (4) Connecticut owes the estate the payment due for March 1983 because the State may not set off a postpetition obligation to the debtor against a prepetition claim against the debtor.

As the State had challenged the constitutionality of a provision of the Bankruptcy Code (as construed by the bankruptcy court), this appeal was deferred until the Attorney General of the United States was apprised of the challenge and permitted to argue the constitutional question. See 28 U.S.C. §2403(b).10/ The United States has

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10/ The following question was certified to the Attorney General:

> whether §106(c) of the Bankruptcy Code, alone or in conjunction with other Code sections, effects or purports

intervened and filed a brief on the constitutional issues.

Discussion

Resolution of this appeal requires an analysis of the following provision of the Bankruptcy Code:

> 11 U.S.C. §106 -- Waiver of sovereign immunity
>
> (a) A governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which such governmental unit's claim arose.
>
> (b) There shall be offset against an allowed claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.

> to effect a waiver or abrogation of a state's eleventh amendment immunity from suit for retrospective money damages and, if so, whether such waiver or abrogation is within congressional power under the Bankruptcy Clause.

> (c) Except as provided in subsections (a) and (b) of this section and notwithstanding any assertion of sovereign immunity--
>
> (1) a provision of this title that contains "creditor", "entity", or "governmental unit" applies to governmental units; and
>
> (2) a determination by the court of an issue arising under such a provision binds governmental units.

After noting that the term "governmental unit" is specifically defined in the Code to include a state government,11/ the bankruptcy court

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Certification Order of June 18, 1985 at 2.

11/ 11 U.S.C. §101(21) provides:

> "governmental unit" means United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States, a State, a Commonwealth, a District, a Territory, a municipality or a foreign state; or other foreign or domestic government.

found the following provision -- addressed to an "entity" (and, hence, by virtue of §106(c), to a state) -- applicable to the debt owed by Connecticut for services rendered by Willington in March 1983:

> 11 U.S.C. §542(b): [A]n entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee, except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor.

"Thus," the court concluded, "Congress has expressly provided that a State is bound by a court judgment ordering it to make payment of a matured debt and a defense of sovereign immunity against a suit brought by a trustee is unavailing." Willington, 39 Bankr. at 786. Therefore, §106(c) was held to

waive sovereign immunity of governmental units as to suits for retroactive monetary damages even in instances where the governmental unit had not filed a proof of claim against the bankrupt estate, as described in subsections 106(a) and (b).

There are two problems with the preceding analysis. The first is that §542 applies to turnover petitions and not, as here, to adversary proceedings for money damages pursuant to a contract claim. The basis of jurisdiction in this action, as the bankruptcy court correctly noted, is the authority of bankruptcy courts to adjudicate claims "arising in or

related to cases under title 11." 28 U.S.C. §1471(b).12/ That section of the Code, however, does not contain the words "creditor", "entity", or "governmental unit," i.e., the terms required to trigger the waiver of sovereign immunity provided for in §106(c).

12/ The full text of 28 U.S.C. §1471(b) reads as follows:

> Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11 or arising in or related to cases under title 11.

"Although the Act initially vests this jurisdiction in district courts," the Supreme Court observed in Northern Pipeline v. Marathon Pipe Line Co., 458 U.S. 50, 54 n. 3 (1982), "it subsequently provides that '[t]he bankruptcy court for the district in which a case under title 11 is

The second and principal difficulty with the bankruptcy court's analysis is that it is premised on a construction of §106(c) which cannot readilty be harmonized with sub-sections (a) and (b). Subsection (a) exposes governmental units to suits without limit where a compulsory counterclaim is filed after the sovereign files its own proof of claim in a bankruptcy proceeding. Subsection

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commenced shall exercise all of the jurisdiction conferred by this section on the district courts,' §1471(c) . . . . (Emphasis added). Thus, the ultimate repository of the Act's broad jurisdictional grant is the bankruptcy courts." Id. (Citation omitted).

In Marathon Pipe Line the Court struck down §1471(b) because it granted to Article I courts power reserved by the Constitution to Article III courts. An emergency resolution adopted by the United States District Judges for the District of Connecticut temporarily

(b) exposes sovereigns to permissive counterclaims (for offset purposes) but, again, only after the sovereign files its own proof of claim. The express waiver of sovereign immunity in the carefully limited circumstances provided for in subsections (a) and (b) would seem to preclude reading subsection (c) as a completely independent wide-open waiver of

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restored the bankruptcy's court "arising in or related to" jurisdiction, pursuant to review and control by the district court, until Congress enacted the 1984 amendments to the Bankruptcy Code codified at 28 U.S.C. §1334.

It should be pointed out that the underlying theory of Marathon Pipe Line is fundamentally in tension with Judge Krechevsky's declaration in Willington that "[i]t is clear that [because of the eleventh amendment and sovereign immunity claims] the debtor could not have brought this suit in a federal court in a nonbankruptcy context." 39 Bankr. at 784.

sovereign immunity which would permit suits against the state for retroactive money damages irrespective of whether the state had first brought suit against the estate. Indeed, subsection (c) begins by specifically acknowledging that its reach as a waiver of sovereign immunity is limited by the two subsections which precede it. The opening words of (c) -- "Except as provided in subsections (a) and (b) of this section" -- seem calculated to prevent subsection (c) from exposing governments to liability for money judgments or set-offs beyond what had been accomplished in the excepted subsections.

Reading subsection (c) as a general waiver of sovereign immunity would appear to compromise at least

three important and related principles of statutory construction: (1) a section of a statute should not be read in isolation from other provisions of the statute, Richards v. United States, 369 U.S. 1, 11 (1962); (2) a statute should not be construed in a way which renders part of it mere surplusage, see Jarecki v. G.D. Searle & Co., 367 U.S. 303, 307-308 (1961) (preferring a "construction which gives effect to all of [a statute's] provisions" to a reading which renders one part "a mere redundancy");13/ and (3) waivers of

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13/ The bankruptcy court did attempt to formulate an interpretation of subsection (c) which would give meaning to subsections (a) and (b):

> [Section] 106(c) by its terms is to be read only with Code provisions addressed to "creditor[s], "enti[ties]" or "governmental

sovereign immunity must be strictly construed in favor of the sovereign, McMahon v. United States, 342 U.S. 25, 27 (1951).

Particularly where the sovereign immunity of a state is at stake, courts must tread warily. In Atascadero State Hospital v. Scanlon, 105 S.Ct. 3142, 3148 (1985), the Supreme Court enjoined courts when construing federal statutes

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unit[s]." Not all Code provisions are so addressed. Sections 545 (statutory liens) and 549 (post-petition transfers) are outside the scope of §106(c)(1). On the other hand, §106(a) and (b) apply to all Code provisions. Thus, there is room for the operation of §106(a) and (b) under this construction of §106(c).

Willington, 39 Bankr. at 786. The court conceded, however, that its construction of §106 might possibly be "too technical and simplistic an answer to Connecticut's 'surplusage'

to be "certain" that Congress intended therein to provide for suits against unconsenting states. There must be "an unequivocal expression of congressional intent," Pennhurst State School and Hospital v. Halderman, 465 U.S. 89, 99 (1984),"in the statute itself," Atascadero, 105 S. Ct. at 3148, before

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argument." Id. In McVey Trucking, Inc. v. Secretary of the State of Illinois (In re McVey Trucking, Inc.), 812 F.2d 322, 327 (7th Cir. 1987), the Court of Appeals found that subsections (a) and (b) describe circumstances in which a state may voluntarily waive sovereign immunity whereas subsection (c) constitutes a forced waiver of sovereign immunity. The problem with that construction of §106 is that it does not adequately address the "surplusage" argument: why would Congress have provided for "voluntary" waiver of sovereign immunity in certain limited circumstances if, in the very next subsection, it had meant to "force" a waiver of sovereign immunity across the board?

concluding that Congress has waived the sovereign immunity of states. After reviewing the Supreme Court's recent pronouncements in this area, the Court of Appeals for the Seventh Circuit concluded it must apply "a somewhat higher standard of proof than is usual in cases of statutory interpretation," one requiring the exercise of "heightened scrutiny" by federal courts. McVey Trucking, Inc., 812 F.2d at 324. "This proof requirement is extremely rigorous "when the effect of the purported federal liability upon the state treasury is potentially severe." Willington, 39 Bankr. at 789, citing Quern v. Jordan, 440 U.S. 332 (1979), and County of Monroe v. State of Florida, 678 F.2d 1124, 1131 (2d Cir.), cert. denied, 459 U.S. 1104 (1983).

In light of the explicit language in subsection (c) excepting the provisions of subsections (a) and (b), it is not "certain" that Congress intended in subsection (c) to expose state governments to suits for money damages in federal courts in the precise circumstances of this case. However, the bankruptcy court quite properly14/ looked beyond the face of

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14/ In McVey, Illinois had argued that it was improper under Atascadero for courts to go beyond the face of the statute to determine whether Congress had provided a cause of action against the state. The Court of Appeals rejected that contention and consulted legislative history "to resolve any lingering uncertainty." 812 F.2d at 324. Although here the conclusion about the meaning of subsection (c) differs from that of the Seventh Circuit and the bankruptcy court, reference to legislative history is often required, and proper, to determine what the words of a statute mean.

the statute and concluded from its legislative history that, even if its reading of subsection (c) rendered subsections (a) and (b) mere surplusage, it was, nevertheless, faithful to what Congress had intended.15/

15/ [E]ven if the above construction of §106(c) were to render §106(a) and (b) surplusage, that result would not be an insuperable obstacle to that construction. [T]he Supreme Court has noted in another context, "even the most basic general principles of statutory construction must yield to clear contrary evidence of legislative intent."

39 Bankr. at 786, citing National R.R. Passenger Corp. v. Passengers Ass'n, 414 U.S. 453, 458 (1974).

Legislative History

An original draft of the Bankruptcy Code as proposed by the Commission on the Bankruptcy Laws of the United States would have made all Code provisions applicable to governmental units. That recommendation was rejected.16/ Instead, the original

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16/ A tax consultant to the Commission testifying before the House and Senate Judiciary Committees expressed as follows his concerns about the effect of the Commission's proposal on state sovereign immunity:

> [The proposal would] have the effect of permitting the bankrupt estate to sue the United States or a State in Bankruptcy Court to recover overpayment of taxes. Today, it is necessary for the estate to go through the more time-consuming process of suing the United States in the District Court or the Court of Claims, and suing the State in whatever forum it provides for that purpose. Congress long ago submitted the Federal Government's

House and Senate versions of the Code were far narrower in scope and included only what now appears essentially as §106(a) and (b). The Report accompanying the measure read, in relevant part:

> affirmative claims for unpaid taxes to the jurisdiction of the Bankruptcy Court in order to speed the closing of estates, and it should not hesitate to do the same concerning claims for overpayments that the Government happens to have collected before the bankruptcy. But I raise for your consideration the question whether Congress, even if it has the power, should undertake to subject the States to suits for tax refunds (or other claims) in courts not of their own choosing. It is true that Congress has long exercised its bankruptcy power to regulate the manner of determining state claims for unpaid taxes, to fix their liens and priority, to bar those not timely presented, and to discharge their tax debtors. But the State in those situations is the moving party, appearing in the Bankruptcy Court in order to share in a fund of which the federal power has

> First, the filing of a proof of claim against the estate by a governmental unit is a waiver by that governmental unit of sovereign immunity with respect to compulsory counterclaims, as defined in the Federal Rules of Civil Procedure, that is, counterclaims arising out of the same transaction or occurrence. The governmental unit cannot receive a distribution from the estate without subjecting itself to liability it has to the estate within the confines of a compulsory counterclaim rule. Any other result would be one-sided.

> validly taken possession, or pursuing a debtor who had been freed of his debts pursuant to federal constitutional power. In the case of claims against the State, I suggest that, even if the constitutional power were clear -- which it is not -- a proper regard for the independence of State governments may outweigh the desireability of providing in the Bankruptcy Courts a possibly more speedy procedure than the States themselves provide for such determinations.

Hearings on H. Rep. 31 and H. Rep. 32 before the Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary, 94th Cong., 2d sess., §27, pt. 4 at 2034-35 (1976) (statement of William T. Plumb, Jr.) (emphasis in original).

> The counterclaim by the estate against the governmental unit is without limit.
>
> Second, the estate may offset against the allowed claim of a governmental unit up to the amount of the governmental unit's claim, any claim that the debtor and thus the estate, has against the governmental unit, without regard to whether the estate's claim arose out of the same transaction or occurrence as the government's claim. Under this provision, the setoff permitted is only to the extent of the governmental unit's claim. No affirmative recovery is permitted. Subsection (a) governs affirmative recovery.
>
> Though this section creates a partial waiver of immunity when the governmental unit files a proof of claim, it does not waive immunity if the debtor or trustee, and not the governmental unit, files proof of a governmental unit's claim . . . .

S. Rep. No. 95-989, 95th Cong., 2d sess., at 29-30. The Senate Report also noted, "Though Congress has the power to waive sovereign immunity for the Federal government completely in bankruptcy cases, . . . Congress does

not . . . have the power to waive sovereign immunity with respect to claims of a bankrupt estate against a State . . . ." Id. That comment is of particular significance -- not because it correctly assesses the extent of Congress' power17/ -- but because it indicates what the authors of the Senate Report believed to be true about the extent of Congress' power.

17/ Although the Supreme Court has held that Congress may, pursuant to §5 of the fourteenth amendment, abrogate a state's immunity from suit in federal court, Fitzpatrick v. Bitzer, 427 U.S. 445 (1976), it has left open the question whether Congress may do so pursuant to one of the enumerated powers in article I, §8 of the Constitution. In McVey, the court of appeals held, as did the bankruptcy court in the instant case, that Congress was authorized by the Bankruptcy Clause to abrogate the eleventh amendment and sovereign immunity of a state. See 812 F.2d at 323 ("Congress may abrogate state immunity to suit pursuant to any of its plenary powers.").

Thereafter, a Conference Committee made minor revisions in subsections (a) and (b) and added subsection (c) for the first time. The Conference Committee offered the following explanation for the addition of §106(c):

> Section 106(c) relating to sovereign immunity is new. The provision indicates that the use of the term "creditor", "entity", or "governmental unit" in Title 11 applies to governmental units notwithstanding any assertion of sovereign immunity and that an order of the court binds governmental units. The provision is included to comply with the requirement in case law that an express waiver of sovereign immunity is required in order to be effective. Section 106(c) codifies In re Gwilliam, 519 F.2d 407 (9th Cir. 1975), and In re Dolard, 519 F.2d 282 (9th Cir. 1975), 519 F.2d 282 (9th Cir. 1975), permitting the bankruptcy court to determine the amount and dischargeability of tax liabilities owing by the debtor or the estate prior to or during a bankruptcy case whether or not the

> governmental unit to which such taxes are owed files a proof of claim. Except as provided in sections 106(a) and (b), subsection (c) is not limited to those issues, but permits the bankruptcy court to bind governmental units on other matters as well. For example, section 106(c) permits a trustee or debtor in possession to assert avoiding powers under Title 11 against a governmental unit; contrary language in the House report . . . is thereby overruled.

124 Cong. Rec. H 11091 (emphasis added); see also 124 Cong. Rec. S 17407.

The bankruptcy court, when quoting the above language, chose to underscore -- not "Except as provided in sections 106(a) and (b)" -- but the last full sentence. The court concluded therefrom that "the final version of §106 abandons the initial, limited approach to the 'waiver' issue and more

nearly approximates the broad approach of the Commission draft." 39 Bankr. at 788.18/

Obviously, subsection (c) was intended to and does waive sovereign immunity in some instances where the government has not filed a proof of

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18/ For support, the court referred to 2 Collier on Bankruptcy §106.04 (15th ed. 1984): "Section 106(c) is as broadly applicable as would be expected from the language employed, and it permits the bankruptcy court to bind governmental units on matters other than tax claims." However, the author of the treatise also observed:

> If a governmental unit desires to assert its rights against a debtor in bankruptcy, it must assume its place with other creditors and suffer the loss of whatever special protection it might otherwise enjoy by reason of the doctrine of sovereign immunity. Even if the rights of a governmental unit are not asserted, section 106(c) authorizes the trustee to recover avoidable transfers from government units.

claim. The Dolard and Gwilliam cases which subsection (c) was designed to codify had held that a specific

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Id. (emphasis added). Inasmuch as Connecticut did not "assert its rights" against Willington, and this is not an action to set aside a preferential transfer, the full quotation from Collier would appear to lend as much support to appellants' construction of §106(c) as to appellee's.

The bankruptcy court also cited with approval a long excerpt from Kennedy, "Automatic Stays Under the New Bankruptcy Law," 12 U. Mich. J. L. Ref. 3, 29 (1978) which included the following: "Although more guardedly drafted, section 106 comes close to adopting the broad provision for general applicability of the bankruptcy laws to the federal or state government that had been recommended by the Commission on the Bankruptcy Laws." However, the court omitted any reference to a revealing footnote accompanying Professor Kennedy's observation:

> Section 106(c) appears to make Title 11 and determinations by the bankruptcy court thereunder fully applicable to every govern-

provision of the prior Bankruptcy

> mental unit insofar as it may be acting or proceeding against the debtor or its property. Subsection (c) is subject to subsections (a) and (b) of section 106, but it is not apparent how these subsections limit the scope of subsection (c).

Id, at 30 n. 120 (emphasis added). Professor Kennedy's frank admission that he is unable to discern the precise nature of the relationship between subsections (a) and (b), and subsection (c), should lead to caution in relying on his expansive reading of subsection (c). Moreover, Professor Kennedy concludes from the legislative history of subsections (a) and (b) that "[t]he allowabilityof neither the counterclaim [subsection (a)] nor the offset [subsection (b)] depends on the filing of a proof of claim by the governmental unit," id. -- a view which has been uniformly rejected by every court which has ruled in cases involving subsections (a) or (b). See, e.g., Community Hosp. of Rockland County v. United States, 5 Bankr. 11, 12 (Bankr. S.D.N.Y. 1980) ("The legislative history . . . makes clear that in order to waive sovereign immunity, it is not enough that the Government have a claim against the Debtor; the Government must have taken the affirmative step of filing that claim in the underlying proceeding.").

Act19/ would be rendered meaningless if a bankruptcy court could not adjudicate the amount and dischargeability of federal income tax liability accruing against the estate. In In re Remke, 5 Bankr. 299 (Bankr. E.D. Mich. 1980), the debtor recovered a preferential transfer from the Internal Revenue Service pursuant to §547 of the Bankruptcy Code, which deals with transfers to or from a "creditor" and, hence, the federal government. Accord In re Community Hosp. of Rockland County, 15 Bankr. 785 (Bankr. S.D.N.Y.

19/ Section 2(a)(2A) of the Bankruptcy Act, as amended in 1966, empowered bankruptcy courts to "[h]ear and determine . . . any question arising as to the amount or legality of any unpaid tax . . . ."

1981) (trustee in Chapter 7 liquidation proceeding may void tax lien payments made within ninety days of the filing of a bankruptcy petition, even if the absence of the government's filing a proof of claim, when such payments meet the statutory requirements of a preferential transfer).20/ See also In

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20/ It is worth noting that in an earlier stage of Community Hospital when the debtor was proceeding on the theory that the I.R.S. tax liens must be subordinated to wage claims owed to employees, the same judge dismissed the complaint and held that because the government had not filed a claim against the estate, it could assert its sovereign immunity with respect to the debtor's subordination claim. In re Community Hosp. of Rockland County, 5 Bankr. 7 (Bankr. S.D.N.Y. 1979), aff'd, 5 Bankr. 11 (Bankr. S.D.N.Y. 1980). The different result in the two Community Hospital cases illustrates the importance of a close examination of the specific nature of the claim being asserted against the governmental unit.

re Howell, 4 Bankr. 102 (Bankr. M.D. Penn. 1980); In re Navear, 674 F.2d 1201 (7th Cir. 1982) (applying §106(c) to abrogate sovereign immunity of federal agencies in adversary proceedings concerning diability benefits received directly by the debtor). However, the preceding cases involved the federal -- not state -- government and were preference

actions21/ in which the relief sought

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of the specific nature of the claim being asserted against the governmental unit.

21/ Indeed, one bankruptcy court has stated that §106(c) was intended to waive sovereign immunity only with regard to preference actions and then only in the case of taxes, In re T & D Management Co., 40 Bankr. 781, 787 (Bankr. D. Utah 1984), while acknowledging that the language of the provision is "much broader" than that. Id. Under prior law, the federal government was immune from preference

was either injunctive or declaratory in nature or based upon the in rem jurisdiction of the court.22/ The only case where subsection (c) has been read to abrogate the sovereign immunity of a state is McVey, which also was a preference action seeking to avoid the transfer of tax payments made by the debtor to the governmental unit.

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actions even where it filed a proof of claim. See In re American Boiler Works, Inc., 123 F. Supp. 352 (W.D. Pa. 1954), aff'd, 220 F.2d 319 (3d Cir. 1955). In Hoffman v. State of Connecticut (In re Zera), Civil No. H-84-830, decided the same day as this case, it is held that under §106(c) sovereigns would not be liable even in preference actions if the result would require funds in the state treasury to flow back to the estate.

22/ According to the United States Justice Department:

> The fair construction of §106 that gives effect to all of its language is that subsection (c) subjects sovereign units to bankruptcy jurisdiction and authority when the bankruptcy court acts pursuant to a specific grant of authority where relief of an injunctive and declaratory nature can be imposed or when the dispute arises within the bankruptcy court's in rem jurisdiction. For retroactive monetary relief, sovereigns have a choice. If they file a claim in the bankruptcy proceeding, they

The only case on all fours with the instant action -- Regal Const. Co. v. State of Maryland (In re Regal Const. Co.), 18 Bankr. 353 (Bankr. D. Md. 1982) -- held that subsection (c) did not authorize a suit for money damages by a debtor against a state government. In Regal, the debtor sought to recover funds (which the state was withholding as liquidated damages) for work performed under a contract with a state agency. The

court found that merely entering into a contract did not waive the state's sovereign immunity nor was §106(c) intended by Congress to do so. See Id. at 357 ("If . . . [as plaintiff had argued] §106(c) constitutes a general waiver of immunity, it would render §106(a) and §106(b), which refer to cases in which states file claims, meaningless."). Absent congressional authorization, the eleventh amendment thus prevented the bankruptcy court

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> consent to liability without limit for matters arising out of the same operative facts as the government's proof of claim or to offset liability in the case of permissive counterclaims. If they do not file, sovereign units have their sovereign immunity protection from liability for retroactive monetary damages intact.

Intervening Brief of the United States at 9.

from assuming jurisdiction:

> Insofar . . . as the counts of the complaint request money that [the state] retains as a setoff of amounts allegedly due to it through contract clauses allowing for liquidated damages, the Eleventh Amendment bars suit. In In re Ramos, 12 B.R. 250 (Bankr. N.D. Ill. 1981), the trustee and debtor attempted to recover funds held by the Illinois Department of Public Aid (IDPA) as a setoff for funds allegedly owed to IDPA by the debtor. In Ramos, as in the instant case, plaintiff claimed that 11 U.S.C. §106 operated as a bar to the state's assertion of sovereign immunity, even though the state had not filed a claim in the bankruptcy case. This court, like the court in Ramos, finds that the Eleventh Amendment bars suit for recovery of funds set off by [the state].

Id. at 358. See Swayne v. State of Washington (In re Crum), 20 Bankr. 160 (Bankr. D. Idaho 1982). See also In re Newlin, 29 Bankr. 781, 784 (Bankr. E.D. Pa. 1983) (finding subsection (c) to be a "limited waiver").

It is found, therefore, that the language and legislative history of §§106(a), (b) and (c), as well as the better reasoned case law interpreting those provisions, support appellants' claim that the Bankruptcy Code did not authorize a suit for retrospective money damages against the State of Connecticut. Although subsection (c) was designed to waive sovereign immunity in certain specific circumstances (e.g., preference actions), it must be read in conjunction with the language and legislative history of subsections (a) and (b). When so read, subsection (c) has a more limited reach than that accorded to it by the bankruptcy court and should not be interpreted as a broad waiver of

sovereign immunity which was originally proposed by the Commission but definitely rejected by Congress. Because it is not "certain" that Congress provided a cause of action against a state in the precise circumstances of the case at bar, the bankruptcy court lacked jurisdiction to adjudicate the trustee's contract action against the State of Connecticut for services rendered by Willington in March 1983. Whether, had it chosen to do so, Congress could have abrogated a state's eleventh amendment immunity from suit pursuant to its power under the Bankruptcy Clause -- a question answered in the affirmative by the bankruptcy court -- need not and should

not be addressed.23/ See New York v. Ferber, 458 U.S. 747, 769 n. 24 (1982) (if a statute is susceptible of an interpretation which avoids a substantial constitutional issue, that interpretation is compelled). However, should the Court of Appeals for the Second Circuit or the United States Supreme Court conclude that the bankruptcy court did properly assert jurisdiction over the trustee's claim, it is found -- for essentially the reasons given in the Brief and reply

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23/ For a thoughtful treatment of this complex issue, see McVey, 812 F.2d at 314-23.

Brief of the Appellants -- that the terms of Willington's contract with Connecticut entitled the state to recoup past overpayments to Willington by withholding the funds due for services provided in March 1983.

Accordingly, the ruling of the bankruptcy court is reversed and appellants' motion to dismiss is granted.

SO ORDERED

/s/ Peter C. Dorsey
United States District
Judge

MEMORANDUM OF DECISION
OF THE DISTRICT COURT
DISTRICT OF CONNECTICUT

(Dated May 8, 1988)

Civil No. H 84-830 (PCD)

UNITED STATES DISTRICT COURT
District of Connecticut

IN RE EDWARD ZERA,
DEBTOR

MARTIN W. HOFFMAN, TRUSTEE

Plaintiff/Appellee/Cross-Appellant

v.

STATE OF CONNECTICUT
DEPARTMENT OF REVENUE SERVICES

Defendant/Appellant/Cross-Appellee

MEMORANDUM OF DECISION

This is an appeal and cross-appeal, pursuant to Bankruptcy Rule 8001 and 28 U.S.C. §1334, from a

ruling of the United States Bankruptcy Court (Krechevsky, J.) denying defendant's motion to dismiss plaintiff's complaint for lack of subject matter jurisdiction and failure to state a claim upon which relief can be granted, Rule 12(b)(1),(6), Fed. R. Civ. P. Hoffman v. State of Connecticut (In re Zera), Bank. No. 2-83-00754 (Bankr. D. Conn. June 8, 1984). The facts summarized by the bankruptcy court and recited in the briefs are not in dispute.

Background

Edward Zera did business as Alyear Maintenance Service. Alyear owed the State of Connecticut Department of Revenue ("Revenue") sales and use taxes

for the quarters of June 30, 1981, through December 31, 1982; a renewal fee due in July 1983; and penalties and interest. Accordingly, on September 22, 1983, Revenue issued a tax warrant, as authorized by Conn. Gen. Stat. §12-35 for $1,977, the total of the taxes, fees, penalties and interest owed. An independently employed officer served the warrant upon Pioneer Systems as garnishee. On or about October 6, 1983, Pioneer paid the $1,977, in addition to a $123.62 service fee due the officer -- a total of $2,100.62.

Zera also owed the State of Connecticut Department of Labor ("Labor") unemployment compensation taxes in the amount of $1,139.69 (later amended to $1,002.91).

On October 7, 1983, Zera filed a Chapter 7 liquidation petition and a trustee was appointed. On October 28, Labor filed a proof of claim for the unemployment compensation taxes.

On January 5, 1984, the trustee filed a complaint against Revenue seeking the return as a preferential transfer1/ of the $2,100.62 received from Zera's garnishee back in October 1983. Revenue then moved to dismiss,

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1/ 11 U.S.C. §547(b) provides:

> Except as provided in subsection (c) of this section, the trustee may avoid any transfer of property of the debtor --
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

arguing that the eleventh amendment2/

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(3) made while the debtor was insolvent;

(4) made --

(A) on or within 90 days before the date of the filing of the petition; or

(B) between 90 days and one year before the date of the filing of the petition, if such creditor, at the time of such transfer --
(i) was an insider; and
(ii) had reasonable cause to believe debtor was insolvent at the time of such transfer; and

(5) that enables such creditor to receive more than such creditor would receive if --

(A) the case were a case under Chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

2/ "The Judicial power of the United States shall not be construed to extend

and the doctrine of sovereign immunity barred the trustee's suit as one for retroactive payment of funds from the state treasury. The trustee opposed the motion, claiming that 11 U.S.C. §106(c)3/ is a constitutional waiver by Congress of a state's eleventh amendment and sovereign immunity and that, in any event, by filing a proof

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to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State or by Citizens or Subjects of any Foreign State." U.S. Const. amend XI.

3/ Section 106 provides:

Waiver of Sovereign Immunity--

(a) A governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which such governmental unit's claim arose.

of claim against the estate Labor had waived (as provided in 11 U.S.C. §106(a)) whatever immunity defenses Revenue might have otherwise asserted.

The bankruptcy court held: (1) with respect to 11 U.S.C. §106(a), that there had been no waiver of sovereign immunity because the trustee's action

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(b) There shall be offset against an allowed claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.

(c) Except as provided in subsections (a) and (b) of this section and notwithstanding any assertion of sovereign immunity --

(1) a provision of this title that contains "creditor", "entity", or "governmental unit" applies to governmental units; and

(2) a determination by the court of an issue under such a provision binds governmental units.

against Revenue was not a compulsory counterclaim to Labor's claim against the estate; and (2) with respect to 11 U.S.C. §106(c), that Congress has the power acting under the Bankruptcy Clause4/ to abrogate the states' eleventh amendment and sovereign immunities, and that by enacting 11 U.S.C. §106(c) it clearly and unequivocally had done so.

Revenue, though content with the bankruptcy court's analysis of the §106(a) issues, appeals the court's conclusions with respect to 106(c). The trustee, though in agreement with the bankruptcy court's views on

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4/ "The Congress shall have Power . . . to establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Const. Art. I, §8.

§106(c), cross-appeals its treatment of §106(a).

Inasmuch as part of Revenue's objections to the bankruptcy court's ruling raised a challenge to the constitutionality of §106(c), this appeal was deferred until the Attorney General of the United States was apprised of the challenge and permitted to argue the constitutional question. See 28 U.S.C. §2403(b). The United States' motion to intervene has been granted and it has filed a brief.

Discussion

Section 106(a)

The State of Connecticut argues that the Departments of Revenue and Labor are two separate "governmental units" within the meaning of 11 U.S.C.

§101(21),5/ so that the filing of Labor's proof of claim waived only that agency's sovereign immunity.6/ The trustee contends that because Labor and Revenue are agencies of the same "governmental unit" -- the State of Connecticut -- the filing of the proof of claim by Labor effected a waiver

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5/ 11 U.S.C. §101(21) defines the scope of the term "governmental unit" as used in §106:

> "Governmental unit" means United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States, a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government.

6/ In the context of this specific case, Connecticut would read §106(a) as follows:

of the sovereign immunity which Revenue seeks to assert.7/

The bankruptcy court did not deem it necessary to resolve the nice question posed above, because it found from its reading of the legislative history of §106(a) that it was intended to apply only with respect to compulsory counterclaims as that term is defined in the Federal Rules of

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> [The Department of Labor] is deemed to have waived sovereign immunity with respect to any claim against [the Department of Labor] that is property of the estate and that arose out of the same transaction or occurrence out of which [the Department of Labor's] claim arose.

Brief of the Appellant/Cross-Appellee at 17.

7/ As stated by the trustee:

> [W]hen a state agency waives sovereign immunity with respect to an action in which the state is the real party in interest,

Civil Procedure.8/ The court concluded that the estate's preference claim against Revenue for the sales and use taxes that had been collected could not be viewed as a compulsory counterclaim

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> it does so not only for itself, but for the governmental unit on whose behalf it acts. The same principles that preclude a party from evading sovereign immunity by suing the state through its agencies or officials preclude one state agency from evading the waiver of sovereign immunity incurred by the action of another . . . . The purpose of §106(a) would be frustrated if the Department of Labor, acting on behalf of the same sovereign authority, could avoid the waiver of sovereign immunity that the statute imposes. When a state invokes the jurisdiction of the bankruptcy court to benefit itself, by filing a proof of claim, it also subjects itself to liability on issues related to that claim.

8/ The Report accompanying the measure read, in relevant part:

to Labor's attempt to recover the

> First, the filing of a proof of claim against the estate by a governmental unit is a waiver by that governmental unit of sovereign immunity with respect to compulsory counterclaims, as defined in the Federal Rules of Civil Procedure, that is, counterclaims arising out of the same transaction or occurrence. The governmental unit cannot receive a distribution from the estate without subjecting itself to liability it has to the estate within the confines of a compulsory counterclaim rule. Any other result would be one-sided. The counterclaim by the estate against the governmental unit is without limit.
>
> Second, the estate may offset against the allowed claim of a governmental unit up to the amount of the governmental unit's claim, any claim that the debtor and thus the estate, has against the governmental unit, without regard to whether the estate's claim arose out of the same transaction or occurrence as the government's claim. Under this provision, the setoff permitted is only to the extent of the governmental unit's claim. No affirmative recovery is permitted. Subsection (a) governs affirmative recovery.

unemployment compensation taxes.9/ Thus, "even accepting, arguendo, the trustee's contention that there is but one governmental unit, Connecticut," Zera, slip op. at 9, the filing of Labor's proof of claim was held not to authorize the estate to go after the funds which had been paid to Revenue.

> Though this section creates a partial waiver of immunity when the governmental unit files a proof of claim, it does not waive immunity if the debtor or trustee, and not the governmental unit, files proof of a governmental unit's claim . . . .

S. Rep. No. 95-989, 95th Cong., 2d sess., at 29-30.

9/ In Federman v. Empire Fire and Marine Ins. Co., 597 F.2d 798, 812 (2d Cir. 1979), the court of appeals listed three factors to be considered when determining whether a counterclaim is compulsory: (1) the identity of facts between the original claim and the counterclaim; (2) the mutuality of proof; and (3) the logical relationship between the original claim and the counterclaim. The bankruptcy

The findings and conclusions of the bankruptcy court with respect to §106(a) are found to be correct and in accordance with the language and legislative history of subsection (a). See Hoffman v. State of Connecticut (In re Willington Convalescent Home, Inc.), Civil No. H-84-830, slip op. at 15-17 (D. Conn. May 8, 1987). Although the trustee contends in this appeal that the debtor's filing of a petition in bankruptcy is the "transaction or occurrence" -- within the meaning of §106(a) -- out of which arose both Labor's filing of its proof of claim and the trustee's action to set aside

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court held that the difference in the transactions involved precluded a finding that the estate's claim was compulsory in nature.

Revenue's preferential transfer, that argument must be rejected as more clever than sound. If the bringing of the bankruptcy proceeding itself were the "transaction or occurrence" linking the two different rights asserted here, then that would mean that any claim by the estate could be brought without limit against a governmental unit, provided only that the governmental unit had filed proof of any claim against the estate. That construction is untenable because it would obliterate the distinction between subsection (a) and subsection (b), that distinction being that only compulsory counterclaims may be prosecuted without limit against a governmental unit filing a proof of claim (subsection (a)) whereas permissive counterclaims (i.e., those

not arising "out of the same transaction or occurrence" out of which the governmental unit's claim arose) may be prosecuted only to the extent that they offset the claims brought by the governmental unit (subsection (b)).

The trustee concedes:

> Judge Krechevsky is correct to state, in regard to the Trustee's and the state's claim, that "the transactions which give rise to each type of tax liability are different." [Zera, slip op. at 9.] The tax warrant that is the subject of the Trustee's claim arose from a different source than the proof of claim.

Brief of the Cross-Appellant at 6. To concede that, however, is to concede the ultimate issue, because, if the trustee's claim against Revenue is not a compulsory counterclaim to Labor's claim against the estate, then it is

not within the purview of subsection (a). Thus, the bankruptcy court validly determined that Connecticut had not waived its immunity with respect to the preferential transfer transaction merely because one of its agencies had filed a proof of claim for payment of other kinds of taxes allegedly owed by the debtor.

Subsection (c)

The bankruptcy court, in construing §106(c), relied heavily on its ruling in In re Willington, 39 Bankr. 785 (Bankr. D. Conn. 1984). The bankruptcy court there held that: (1) §106(c) clearly and unambiguously expressed Congress' intention to waive the common-law sovereign immunity of states by making them subject to bankruptcy court orders issued

pursuant to any provision of the bankruptcy laws containing a reference to "creditor", "entity", or "governmental unit"; (2) 28 U.S.C. §1471(b)10/ provided the jurisdictional vehicle by which the liability created by §106(c) could be enforced in federal court, thereby abrogating the eleventh amendment immunity of states; and (3) Congress' authority pursuant to the Bankruptcy Clause of the Constitution was sufficient to empower Congress to do what it had accomplished in §106(c) and §1471(b). Accord Mcvey Trucking,

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10/ 28 U.S.C. §1471(b) provides: "Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction conferred by this section on the district courts."

Inc. v. Secretary of State of Illinois (In re McVey Trucking, Inc.), 812 F.2d 322 (7th cir. 1987).

In the case at bar, the bankruptcy court found that, because the provision governing the avoidance of preferential transfers (11 U.S.C. §547) contained the word "creditor," it was, by virtue of §106(c), applicable to any governmental unit, including Revenue. Thus, §547(b), when read in conjunction with §550(a)11/ (which also contains one of

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11/ 11 U.S.C. §550(a) provides:

> Except as otherwise provided in this section, to the extent that a transfer is avoided under section . . .547, . . . the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from --

the §106(c) trigger words, to wit, "entity"), authorized the trustee to recover from the State treasury the money Zera's debtor paid in satisfaction of Zera's sales and use tax obligations.

With all due respect to the bankruptcy court and the Seventh Circuit, this court has a different view of §106(c), one not requiring a pronouncement on the momentous constitutional issues reached in Willington and McVey. As explained in this court's ruling on the Willington appeal, the critical words of subsection (c) are contained in its opening subordinate clause: "Except as

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(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made . . . .

provided in subsections (a) and (b) of this section, ..." Those words indicate that the waiver of sovereign immunity effected by subsection (c) is limited by the exceptions provided in subsection (a) and (b) so that the only situation in which state funds can actually be ordered by the bankruptcy court to be paid to the estate is pursuant to subsection (a) under circumstances where the state files a proof of claim and the estate can assert a compulsory counterclaim which exceeds the amount of the state's claim.

It is conceded that §106(c) was specifically designed to abrogate sovereign immunity in preference

actions, even when the governmental unit files no proof of claim.12/ However, "properly construed," as the United States argues in its intervening brief,

> §106(c) permits the trustee to bring preference actions against a sovereign in a bankruptcy court [only] where that court has jurisdiction to enforce its order. Thus, with regard to actions in rem, where the trustee seeks to set aside a preferential lien of a sovereign on property within the estate, the sovereign would be bound by the bankruptcy court's determination notwithstanding its failure to file a proof of claim . . . . However, the legislative history does not reveal that sovereign units would be liable even for preference actions which would expend themselves on the sovereign's treasury in the form of retroactive monetary damages.

12/ Under prior law, the United States was immune from preference actions, even where it filed a proof of claim. In re American Boiler Works, Inc., 123 F. Supp. 352 (W.D. Pa. 1954), aff'd, 220 F.2d 319 (3d Cir. 1955).

Intervening Brief of the United States at 8 (emphasis added).13/

Where the eleventh amendment immunity of a state is in the balance, the Supreme Court requires "an unequivocal expression of congressional intent" that the states' immunity was meant to be compromised. Pennhurst State School and Hospital v. Halderman, 465 U.S. 89, 99 (1984). Neither 11 U.S.C. 106(c) nor 28 U.S.C. §1471 or 11 U.S.C. §547(b) are unequivocal expressions of congressional intent to abrogate the states' immunity to suit in bankruptcy court for recovery of funds from the state treasury.

13/ In McVey, the Seventh Circuit rejected the distinction between voiding a preferential tax lien and ordering the return of funds in the

Accordingly, the order of the bankruptcy court dismissing Revenue's motion to dismiss is reversed and the cause is remanded to that court for

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state treasury:

> A tax lien, like a claim for the proceeds of its bank accounts, is an asset of a state treasury. Voiding a lien is little different from ordering the state treasurer to pay over a portion of the contents of the state's bank account. If Article III allows a court to take the former action, it must certainly allow the latter.

812 F.2d at 323. If, however, the eleventh amendment was intended to accomplish anything, it was to prevent raids on the state treasury conducted in federal court. When resolving delicate issues involving state/federal relations, the difference between voiding a State's tax lien and ordering payment from the State's bank account is crucial. That difference is similar in concept to the one between according State property tax exemptions to religious organizations and subsidizing religious organizations with State funds: the impact on the State treasury may be equally severe, but the former is constitutional and the latter is not.

the purpose of dismissing the action against Revenue.

SO ORDERED

/s/ Peter C. Dorsey
United States District
Judge

MEMORANDUM AND ORDER OF THE
UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

(Dated April 25, 1984)

In Bankruptcy No. 2-82-00508
Adversary Proceeding No. 2-84-0007

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

WILLINGTON CONVALESCENT HOME, INC.

Debtor

MARTIN W. HOFFMAN, TRUSTEE

Plaintiff

v.

STATE OF CONNECTICUT,
DEPARTMENT OF INCOME MAINTENANCE
DEPARTMENT OF HEALTH SERVICES,

Defendant

APPEARANCES:

MARTIN W. HOFFMAN, ESQ., 410 Asylum Street, Hartford, Connecticut 06103 Attorney for Trustee, Plaintiff

KENNETH A. GRAHAM, Assistant Attorney General, and Arnold I. Menchel, Assistant Attorney General, State of Connecticut, 90 Brainard Road, Hartford, Connecticut 06114, Attorney for Connecticut Department of Income Maintenance, Defendant

STANLEY K. PECK, Assistant Attorney General, State of Connecticut, 90 Washington Street, Hartford, Connecticut 06106, Attorney for Connecticut Department of Health Services, Defendant

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MEMORANDUM AND ORDER

KRECHEVSKY, B.J.

I.

ISSUES

This proceeding raises complex issues of constitutional dimension where there is conflicting authority in the courts and no controlling precedent in this circuit. The court is first called upon to resolve the intent of Congress, and the power of Congress to implement that intent, in the Bankruptcy Code provisions which impinge upon the sovereign immunities enjoyed by a State. Thereafter, the court must determine the consequences of the filing of a bankruptcy petition

upon the right of a State, postpetition, to "recoup" for prepetition Medicaid overpayments under a Medicaid contract between a State and a debtor convalescent home.

II.

BACKGROUND

Willington Convalescent Home, Inc., (debtor), filed a chapter 11 petition on June 2, 1982. At that time, the debtor was a state-licensed skilled nursing facility and a provider-participant in the Connecticut Medicaid program. Under that program, the debtor periodically contracted with the Connecticut Department of Income Maintenance, (Connecticut), to provide patient-care services to indigent persons at a per diem rate payable by Connecticut. After the filing of the bankruptcy petition, the debtor's existing provider agreement (contract)

was not presented to the bankruptcy court for assumption or rejection. The daily rates paid by Connecticut under such contracts are subject to review and recomputation upon audit of the books and records of a provider-participant. After such an audit, Connecticut concluded in rate decisions issued in February and August, 1982 that the debtor had utilized unallowable costs to support its per diem rate and that the debtor owed it monies representing overpayment by Connecticut for Medicaid patients for the years commencing July 1, 1976 through 1980. In the spring of 1983, the debtor ceased operation as a convalescent home and the court, on July 27, 1983, converted the case to one under Chapter 7 and appointed Martin W. Hoffman as trustee. On January 3, 1984, the trustee filed a

complaint in this court against the Connecticut Department of Income Maintenance and Department of Health Services seeking $64,010.24 money damages for services rendered under the Medicaid program during the month of March 1983, for which no remittance had been received. Connecticut admits the rendering of the services but claims that by virtue of the contract between it and the debtor and the implementing regulations,[1] it is entitled to recoup

(1) Section 17-311-53 of the regulations adopted by Connecticut to apply to the Medicaid cost-related reimbursement system provides, in part, as follows:

> (b) Whenever the commissioner of Income Maintenance renders a rate decision, whether based upon a field audit or otherwise, which decision results in the facility being indebted to the Department of Income Maintenance for past medicaid overpayments, the Department shall recoup said medicaid overpayments as soon as possible from the Department's monthly medicaid payments to the facility.

the past Medicaid overpayments and not pay the trustee. Connecticut has not filed a proof of claim against this estate although it asserts that it is still owed $121,408.82 based upon

> (c) In a recoupment situation, the Department of Income Maintenance shall determine a recoupment schedule of amounts to be recouped from the facility's monthly medicaid payments after consideration of the following factors:
>
> (1) the amount of the indebtedness;
> (2) the objective of completion of total recoupment of past medicaid overpayments as soon as possible;
> (3) the cash flow of the facility; and
> (4) any other factors brought to the attention of the department by the facility relative to the provider's ability to function after recoupment.
>
> (d) Whenever a facility has received past medicaid overpayments, the Department may recoup the amount of such medicaid overpayments from the monthly medicaid payments to the facility regardless of any intervening change in ownership.

overpayments to the debtor. By such noninvolvement with the estate,[2] Connecticut asserts that both its common-law sovereign immunity and its immunity under the Eleventh Amendment[3] to the United States Constitution bar a federal bankruptcy court from entering

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(2) The Connecticut Department of Labor and Department of Revenue Service have filed proofs of claim seeking priority status for unpaid prepetition employment compensation taxes ($2,946.00) and unpaid prepetition corporation business taxes ($61.06), respectively, but the trustee has made no argument concerning these filings.

(3) The Eleventh Amendment provides:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State or by Citizens or Subjects of any Foreign State.

U.S. Const. Amend. XI, U.S.C.A. (West 1972).

any judgment against it. These issues have been raised by Connecticut through a motion to dismiss the trustee's complaint for lack of subject matter jurisdiction and for failure to state a claim upon which relief can be granted, pursuant to Fed. R. Civ. P. 12(b)(1) and 12(b)(6), made applicable by Fed. R. Bankr. P. 7012(b). The foregoing statement of facts has been derived from the affidavits and memoranda filed by Connecticut and the trustee. Those parties agree that the record is sufficient for the purposes of a court ruling.[4]

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(4) Fed. R. Civ. P. 12(b) provides that "[i]f, on a motion asserting the defense numbered (6) to dismiss for failure of the pleading to state a claim upon which relief can be granted, matters outside the pleading are presented to and are not excluded by the court, the motion shall be treated as one for summary judgment ... "

III.

SOVEREIGN IMMUNITY

The question here is the extent to which Congress did or could abrogate the common-law immunity and the immunity from suit enjoyed by a State under the Eleventh Amendment of the United States Constitution, when Congress enacted §106 of the Bankruptcy Code of 1978,[5] pursuant to the power

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(5) 11 U.S.C. § 106 - Waiver of sovereign immunity.

(a) A governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which such governmental unit's claim arose.

(b) There shall be offset against an allowed claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.

(c) Except as provided in subsections (a) and (b) of this

conferred by Art. I, § 8 of the Constitution (the Bankruptcy Clause).[6]

Connecticut phrases its position in its motion to dismiss as follows:

> The Eleventh Amendment to the Constitution of the United States operates as a bar to the trustee's complaint because the entirety of said complaint seeks retroactive pecuniary relief from a federal court against a state government where the state has not waived its Eleventh Amendment immunity.

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section and notwithstanding any assertion of sovereign immunity --

(1) a provision of this title that contains "creditor", "entity", or "governmental unit" applies to governmental units; and

(2) a determination by the court of an issue arising under such a provision binds governmental units.

11 U.S.C. § 106 (West 1979)

(6) The Congress shall have Power ... to establish ... uniform Laws on the subject of Bankruptcies throughout the United States ... .

U.S. Const. Art. I, § 8, U.S.C.A. (West 1968).

> The sovereign immunity enjoyed by the State of Connecticut operates as a bar to the trustee's complaint as the defendant State Agencies have filed no claim against debtor's estate, no objection to discharge, no request for affirmative relief from the bankruptcy court and are not the plaintiffs in any other forum pursuing a claim against the debtor's estate.

Connecticut's Motion at 2.

It is clear that the debtor could not have brought this suit in a federal court in a nonbankruptcy context. Department of Health v. Florida Nursing Home Assn., 450 U.S. 147, 101 S. Ct. 1032, 67 L.Ed.2d 132 (1981). (A State's waiver of sovereign immunity in its own courts is not a waiver of the Eleventh Amendment in the federal courts; a State's participation in Medicaid programs likewise is not a waiver.) It is also clear that under the prior Bankruptcy Act the Eleventh Amendment would have barred the

trustee's suit in a federal court. In re Friendship Medical Center, Ltd., 710 F.2d 1297 (7th Cir. 1983) (When State has filed claim against estate Federal court cannot adjudicate cause of action against State payable out of State treasury if cause of action does not arise from same transaction as claim); State of Ohio v. Madeline Marie Nursing Homes, 694 F.2d 449 (6th Cir. 1982) (Same).

The effect of the enactment of § 106 (c) on suits of this type is not clear from a review of the decisions in the bankruptcy courts to date. Courts have uniformly held that § 106(c) waives the sovereign immunity of the federal government as to suits for retrospective money damages. See, e.g., Remke, Inc. v. United States (Matter of Remke, Inc.), 5 Bankr. 299

(Bankr. E.D. Mich. 1980) (Preference action against I.R.S.) Ellenberg v. Dekalb County (In re Maytag Sales and Service, Inc.), 23 Bankr. 384, 9 B.C.D. 908, 7 C.B.C. 2d 405 (Bank. N.D. Ga. 1982), holds, in the alternative, that § 106(c) waives any alleged sovereign immunity of a Georgia county in a preference action. Cf. C.A. Wright, Law of Federal Courts, § 46 at 274 (4th ed. 1983) (Counties do not share States' Eleventh Amendment immunity). When a State has filed a claim against the estate, bankruptcy courts have held that § 106(a) and (b) authorize suits within that court against the State for retrospective monetary relief. See, e.g., In re Greenwald, 33 Bankr. 607 (Bankr. S.D.N.Y. 1983) (Section 106(b) set-off of debtor's, nursing home's, claim for Medicaid reimbursement from State Department of Health against

claim filed by Department against estate not barred by Eleventh Amendment); Ehre v. People of the State of New York (In re Adirondack Ry. Corp.), 28 Bankr. 251, 10 B.C.D. 256 (Bankr. N.D.N.Y. 1983) (Debtor's claim for payments from State on construction contract arose from the same transaction as State's claim for withholdings from employee salaries and sales tax on materials used by debtor to perform contract; State's sovereign immunity waived pursuant to § 106(a)). And bankruptcy courts have taken jurisdiction over § 542(a) turnover actions against a State, without any discussion of the Eleventh Amendment or State consent. See, e.g., Aegean Fare, Inc. v. Commonwealth of Massachusetts (In re Aegean Fare, Inc.) 33 Bankr. 745

(Bankr. D. Mass. 1983); Troy Indus. Catering Service v. State of Michigan (Matter of Troy Indus. Catering Service), 2 Bankr. 521, 5 B.C.D. 1243, 1 C.B.C. 2d 321 (Bankr. E.D. Mich. 1980). See, also United States v. Whiting Pools, Inc., -- U.S. --, 103 S. Ct. 2309, 76 L.Ed.2d 515 (1983) (I.R.S. is "entity" subject to § 542(a) turnover order). Connecticut relies upon three bankruptcy court opinions which hold that § 106 (c) does not, by its terms, authorize bankruptcy court suits by the estate for retrospective monetary relief against a State which has not filed a claim or otherwise consented to jurisdiction. See Regal Const. Co., Inc. v. State of Maryland (In re Regal Const. Co., Inc.), 18 Bankr. 353, 357, 6 C.B.C.2d 187, 191 (Bankr. D. Md. 1982) ("[T]he Bankruptcy

Code contains no indication that Congress intended to overturn Eleventh Amendment immunity, even if it could"); Swayne v. State of Washington (Matter of Crum), 20 Bankr. 160, 161, 9 B.C.D. 183, 184, 6 C.B.C. 2d 868, 869 (Bankr. D. Idaho 1982) ("The only exceptions to the operation of the amendment arise when the State consents to such suit or waives the protection of the 11th Amendment, which Washington has not done here ..."); Cohen v. Illinois Department of Public Aid (In re Ramos), 12 Bankr. 250, 251, 7 B.C.D. 1114, 1115, 4 C.B.C.2d 1016, 1017 (Bankr. M.D. Ill. 1981) ("[Section 106] does not operate as a waiver ... of Illinois' sovereign immunity absent action by Illinois or one of the State's agencies or departments.") Since there is no controlling precedent

in this circuit and the cases from other jurisdictions are not uniform in their analysis, a careful examination of the underpinnings of § 106 is in order to determine whether or not Congress intended to authorize suits of this type and, if it did, whether or not Congress had the power under the Constitution to enact such an authorization.

A.

§ 106 and Legislative History

Section 106(c) provides:

> [N]otwithstanding any assertion of sovereign immunity --
>
> (1) a provision of this title that contains "creditor", "entity", or "governmental unit" applies to governmental units; and
>
> (2) a determination by the court of an issue arising under such a provision binds governmental units.

11 U.S.C.A. § 106(c) (West 1979).

> "Governmental unit" is a term defined elsewhere in the Code and means United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency or instrumentality of the United States, a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government... .

11 U.S.C.A. § 101(21) (West 1979).

One of the Code provisions which is addressed to an "entity" is § 542(b) which provides:

> [A]n entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee, except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor.

11 U.S.C.A. § 542 (b) (West 1979).

Thus, Congress has expressly provided that a State is bound by a court judgment ordering it to make payment of a matured debt and a defense of sovereign immunity against a suit

brought by a trustee is unavailing.

Connecticut argues the foregoing statutory construction renders § 106(a) and (b) surplussage. See In re Regal Const. Co., Inc., 18 Bankr. at 357, 6 C.B.C.2d at 191. As noted, § 106(c) by its terms is to be read only with Code provisions addressed to "creditor[s]", "enti[ties]" or "governmental unit[s]." Not all Code provisions are so addressed. Sections 545 (statutory liens) and 549 (post-petition transfers) are outside the scope of § 106(c)(1). On the other hand, § 106(a) and (b) apply to all Code provisions. Thus, there is room for the operation of § 106(a) and (b) under this construction of § 106(c).

Possibly the above construction of § 106 is too technical and simplistic an answer to Connecticut's "surplussage" argument. However, even

if the above construction of § 106(c) were to render § 106(a) and (b) surplussage, that result would not be an insuperable obstacle to that construction. As the Supreme Court has noted in another context, "[E]ven the most basic general principles of statutory construction must yield to clear contrary evidence of legislative intent," Nat. R.R. Passenger Corp. v. Passengers Assn., 414 U.S. 453, 458, 94 S. Ct. 690, 693, 38 L.Ed.2d 646, 652 (1974) (citation omitted). Therefore, a search for the legislative intent behind § 106, and especially § 106(c), is now appropriate.

The original draft of the proposed Bankruptcy Code submitted to the Ninety-Third Congress by the Commission on the Bankruptcy Laws of the United States contained tne following

provision and accompanying note:

> Section 1-104. Applicability of Act to United States, States and Subdivisions. All provisions of this Act shall apply to the United States and to every department, agency and instrumentality thereof, and to every state and every subdivision thereof except where otherwise specifically provided. This section does not render any branch or unit of the government eligible for relief as a petitioner except as provided in Chapter VIII, or subject to relief as a debtor upon an involuntary petition.
>
> NOTE
>
> This section, with the exceptions indicated, answers the question whether all of the provisions of this Act are intended to apply to federal and state governments and to all subdivisions and instrumentalities thereof.

Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93d Cong., 1st Sess. Pt. II at 10 (1973) (reproduced in Collier on Bankruptcy, Appendix 2 § I (15th ed. 1984)) (emphasis added).

The original, identical House and Senate versions of current § 106, contained in H.R. 8200 and S. 2266, were far narrower in scope. H.R. 8200 and S. 2266 provided:

> § 106. Waiver of sovereign immunity.
>
> (a) A governmental unit that files a proof of claim under section 501 of this title is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which such governmental unit's claim arose.
>
> (b) There shall be offset against an allowed claim or interest of a governmental unit for which such governmental unit filed a proof of claim or interest under section 501 of this title any claim against such governmental unit that is property of the estate.

H.R. 8200, 95th Cong., 1st Sess. 324 (1977); S. 2266, 95th Cong., 2d Sess. 313 (1978) (reproduced in Collier,

Appendix 3 §§ III, VII). The reports circulated with the two bills were also identical and indicated the limited reach of this prelimary version of § 106 as follows:

> Section 106 provides for a limited waiver of sovereign immunity in bankruptcy cases. Though Congress has the power to waive sovereign immunity for the Federal government completely in bankruptcy cases, the policy followed here is designed to achieve approximately the same result that would prevail outside of bankruptcy. Congress does not, however, have the power to waive sovereign immunity completely with respect to claims of bankrupt [sic] estate against a State, though it may exercise its bankruptcy power through the supremacy clause to prevent or prohibit State action that is contrary to bankruptcy policy.
>
> . . .
>
> Though this subsection creates a partial waiver of immunity when the governmental unit files a proof of claim, it does not waive immunity if the debtor or trustee, and not the governmental unit, files proof of a governmental unit's claim under proposed 11 U.S.C. § 501(c).

> This section does not confer sovereign immunity on any governmental unit that does not already have immunity. It simply recognizes any immunity that exists and prescribes the proper treatment of claims by and against that sovereign.

H.R. Rep. 595, 95th Cong., 1st Sess. 317 (1977); S. Rep. 989, 95th Cong., 2d Sess. 29-30 (1978) (reproduced in Collier, Appendix 2 § II, Appendix 3 § V).

After H.R. 8200 and S. 2266 had been sent to the Conference Committee, § 106 was amended for the last time. Sections 106(a) and (b) were reworded and § 106(c) made its initial and permanent appearance. An identical explanatory statement of § 106(c) was given to both houses of Congress and was made as follows:

> Section 106(c) relating to sovereign immunity is new. The provision indicates that the use of the term "creditor", "entity", or "governmental unit" in title 11

applies to governmental units notwithstanding any assertion of sovereign immunity and that an order of the court binds governmental units. The provision is included to comply with the requirement in case law that an express waiver of sovereign immunity is required in order to be effective. Section 106(c) codifies in re Gwilliam, 519 F.2d 407 (9th Cir., 1975), and in re Dolard, 519 F.2d 282 (9th Cir., 1975), permitting the bankruptcy court to determine the amount and dischargeability of tax liabilities owing by the debtor or the estate prior to or during a bankruptcy case whether or not the governmental unit to which such taxes are owed filed a proof of claim. Except as provided in sections 106(a) and (b), subsection (c) is not limited to those issues, but permits the bankruptcy court to bind governmental units on other matters as well. For example, section 106(c) permits a trustee or debtor in possession to assert avoiding powers under title 11 against a governmental unit; contrary language in the House report to H.R. 8200 is thereby overruled.

124 Cong. Rec. H. 11091 (Sept. 28, 1978) (remarks of Rep. Edwards); S. 17407 (Oct. 6, 1978) (remarks of Sen. DeConcini)(reproduced in Collier,

Appendix 3 §§ IX at IX-90, X at X-16) (emphasis added). Thus, the final version of § 106 abandons the initial, limited approach to the "waiver" issue and more nearly approximates the broad approach of the Commission draft. As an early and leading commentator has observed:

> Under the version of section 106 as it originally passed both houses of Congress, the government could have argued with considerable success that a waiver of sovereign immunity by any governmental unit would depend on the filing of a proof of claim or interest by the unit involved. The section thus could have been construed as overruling the many cases that have held the government suable under section 2a(2A) and (12) of the Bankruptcy Act when the debtor seeks a determination of dischargeability of tax or other governmental claim. The courts have rejected as immaterial to their jurisdiction under the Bankruptcy Act that the governmental unit has filed no proof of claim. Section 106(c) as finally enacted provides that notwithstanding any assertion of sovereign immunity, any provision of Title 11 referring to

"creditor", "entity", or "governmental unit" applies to governmental units, and "a determination by the court of an issue arising under such provision binds governmental units." According to the legislative history, the purpose is "to comply with the requirement in case law that an express waiver of sovereign immunity is required in order to be effective." Although more guardedly drafted, section 106 comes close to adopting the broad provision for general applicability of the bankruptcy laws to the federal or state government that had been recommended by the Commission on the Bankruptcy Laws. The scope of a waiver of sovereign immunity is essentially a matter of determining congressional intent.

F.R. Kennedy, Automatic Stays Under the New Bankruptcy Law, 12 U. Mich. J. of Law Reform 3, 29 (1978). See also 2 Collier on Bankruptcy, Para. 106.04 at 106-9 to 106-10 (15th ed. 1984) ("Section 106(c) is as broadly applicable as would be expected from the language employed, and it permits the bankruptcy court to bind

governmental units on matters other than tax claims. For example, section 106(c) permits a trustee or debtor-in-possession to assert avoiding powers granted under title 11 (See, e.g., section 548) against a governmental unit") (footnotes omitted). I, therefore, conclude there is "clear ... evidence of legislative intent," Nat. R.R. Passenger Corp. v. Passengers Assn., supra, from both the plain language of § 106(c) and its legislative history demonstrating that Congress contemplated that a State be answerable to the estate in money damages in a situation comparable to that presented here.

B.

§ 106(c) And The Eleventh Amendment Immunity

Connecticut claims that even if § 106(c) effectively "waives" its

sovereign immunity, its Eleventh Amendment immunity is untouched. The term "sovereign immunity" embraces two distinct concepts -- "whether [a State] may be sued," Pennhurst State School & Hospital v. Halderman, -- U.S. --, 104 S. Ct. 900,, 907, 79 L.Ed.2d 67, 78 (1984) (emphasis in original), or common-law sovereign immunity, and "where [a State] may be sued," id., or constitutional sovereign immunity in the Eleventh Amendment.

The quantum of proof concerning Congress' intent to abrogate the Eleventh Amendment is high for "[w]hen Congress' intent to abrogate is unclear, a state's Eleventh Amendment immunity will be upheld." County of Monroe v. State of Fla., 678 F.2d 1124, 1131 (2d Cir.), cert. denied, 103 S. Ct. 726 (1982) (citations omitted).

This proof requirement is extremely rigorous when the effect of the purported federal liability upon the state treasury is potentially severe. Quern v. Jordan, 440 U.S. 332, 99 S.Ct. 1139, 59 L.Ed.2d 358 (1979); County of Monroe v. State of Fla., supra.

In § 106, Congress has clearly and unambigously answered in the affirmative the question of whether the State may be sued, but Congress did not address in § 106 the question of where that liability could be enforced. However, as another part of the Bankruptcy Reform Act of 1978, Congress passed the statute which is codified at 28 U.S.C. § 1471(b) and which provides:

> Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11 or arising in or related to cases under title 11.

28 U.S.C.A. § 1471(b)(West 1983 Supp.). This jurisdictional provision, by its terms, applies to all civil proceedings and makes no special mention of proceedings against States. However, the Supreme Court cases have never suggested that if Congress expressly provides for State liability under a federal statutory scheme, that a general grant of concurrent jurisdiction to the federal courts over cases arising under that statutory scheme would be sufficient to cover actions against a State. See, e.g., Parden v. Terminal R. of Alabama Docks Dept., 377 U.S. 184, 190 n. 8, 84 S. Ct. 1207, 1212 n. 8, 12 L.Ed.2d 233, 239 n. 8 (1964). Moreover, § 1471 evinces a strong legislative intent that the estate have the benefit of bringing all its litigation in the single federal forum. Therefore,

I conclude that Congress not only waived the State's common-law sovereign immunity but intended that such waiver be enforced in the federal courts.

C.

Congress' Power to Abrogate The Eleventh Amendment Immunity Under The Bankruptcy Power

The question remains that if Congress intended to abrogate the Eleventh Amendment immunity in § 106 and § 1471(b), can it do so pursuant to the Bankruptcy Clause? Parden v. Terminal R. of Alabama Docks Dept., supra, established that Congress can provide that a State's conducting activity validly subject to federal regulation under Art. I, § 8 will waive the State's Eleventh Amendment immunity. Fitzpatrick v. Bitzer, 427 U.S. 445, 96 S. Ct. 2666, 49 L.Ed.2d 614 (1976), decided that Congress has

the power to abrogate the Eleventh Amendment immunity pursuant to legislation enforcing the Fourteenth Amendment without any requirement that the State subsequently consent expressly or otherwise. However, the Supreme Court has not addressed the issue presented here of whether or not Congress can abrogate the Eleventh Amendment immunity without subsequent State consent pursuant to an Art. I, § 8 power.

There is relevant authority from the Courts of Appeals. The Fifth Circuit employed the following rationale in Peel v. Florida Dept. of Transp., 600 F.2d 1070 (5th Cir. 1979) when a state employee sued Florida in federal court for back wages and benefits under the Veterans Reemployment Rights Act, passed by

Congress pursuant to the Art. I, § 8 War Power Clause:

> [A] state consents to private damage actions when Congress manifest a sufficient purpose to abrogate a state's immunity. Under this approach, the state waived its immunity and gave Congress the power to legislate under delegated powers. As recognized by Chief Justice Hughes in an early case involving sovereign immunity, "States of the Union, still possessing attributes of sovereignty, shall be immune from suits, without their consent, save where there has been a surrender of this immunity in the plan of the convention." Monaco v. Mississippi, 292 U.S. 313, 322-23, 54 S.Ct. 745, 748, 78 L.Ed. 1282 (1934) (quoting the Federalist No. 81 (A. Hamilton)) (footnote omitted). This rationale removes the eleventh amendment as a bar whenever Congress validly has exercised its powers.

Peel, 600 F.2d at 1080. The Peel court raced the trend of Supreme Court authority from Parden v. Terminal Railway, 377 U.S. 184, 84 S. Ct. 1207, 12 L.Ed.2d 233 (1964) to Quern v. Jordan, 440 U.S. 332, 99 S. Ct. 1139,

59 L.Ed.2d 358 (1979), Peel, 600 F.2d at 1075-79, and concluded:

> [W]e are persuaded that nothing in the history of the eleventh amendment, the doctrine of sovereign immunity, or the case law indicates that Congress, when acting under an article I, section 8 delegated power, lacks the authority to provide for federal court enforcement of private damage actions against the states.

Peel, 600 F.2d at 1080. The Seventh Circuit used similar analysis in another Veterans Reemployment Rights Act case in Jennings v. Illinois Office of Ed., 589 F.2d 935 (7th Cir.), cert. denied, 441 U.S. 967 (1979) (Abrogation without subsequent consent pursuant to the War Power Clause). The Third Circuit relied upon Peel and Jennings when it held in Gardner v. Com. of Pa. Dept. of Public Welfare, 685 F.2d 106 (3d Cir.), cert. denied, 103 S. Ct. 580 (1982), as an alternative holding, that Congress could abrogate a State's

Eleventh Amendment immunity pursuant to the Bankruptcy Clause. Gardner, 685 F.2d at 109 ("[I]f Congress intends to bind the states by a cause of action arising under federal law, the eleventh amendment is no bar.").

The Second Circuit appeared to accept the Peel analysis to the extent necessary to find valid abrogation without the need for subsequent State consent in County of Monroe v. State of Fla., 678 F.2d 1124 (2d Cir), cert. denied, 103 S. Ct. 726 (1982) (Abrogation without subsequent consent pursuant to Art. IV Extradition Clause), and Oneida Indian Nation of N.Y. v. State of N.Y., 691 F.2d 1070 (2d Cir. 1982) (Abrogation without subsequent consent pursuant to Art. I, § 8, cl. 3, Commerce with the Indians

(7)
Clause) (Oneida I). However, in Oneida Indian Nation of New York v. Oneida County, 719 F.2d 525 (2d Cir. 1983) (Oneida II), this Circuit again addressed the Eleventh Amendment immunity question in the context of the Commerce with the Indians Clause.

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(7) When the states granted to Congress the power "[t]o regulate commerce ... with the Indian tribes," U.S. Constitution, Art. I, § 8, cl. 3, they necessarily "surrendered a portion of their sovereignty"... and thereby granted Congress the power to abrogate the states' immunity from suits upon claims arising out of such regulation. In enacting 28 U.S.C. § 1362 pursuant to this authority, Congress clearly intended to abrogate the states' immunity from suit.

...

We conclude, therefore, that Congress' intent in enacting §1362 to provide Indian tribes with a capacity to sue that is as broad in some respects as that of the United States indicates an intent to remove the states' Eleventh Amendment immunity in suits brought by the tribes.

Oneida I, 691 F.2d at 1079-1080 (citations and footnotes omitted).

In Oneida II, the court relied solely upon a waiver-by-subsequent-conduct theory without mentioning abrogation (8)
pursuant to Art. I, § 8, cl. 3. Oneida II, 719 F.2d 543-544 and 543 n. 25. Oneida II, however, did not reject the rationale of County of Monroe and Oneida I, and based upon the ruling of those two earlier cases, as well as Peel, Jennings and Gardner, I hold that in § 106, Congress validly abrogated the Eleventh Amendment immunity pursuant to the Bankruptcy Clause,

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(8) The Supreme Court has recently granted certiorari in Oneida II inter alia to resolve the question of whether a State, by negotiating treaties with an Indian tribe in alleged violation of 1793 Trade and Intercourse Act can be held to have waived impliedly its immunity to suit in federal court by non-Indian claimants. See 52 U.S.L.W. 3678.

regardless of the absence of subsequent State manifestations of consent.

IV.

RECOUPMENT

Connecticut argues that it does not owe debtor any money for the services rendered in March 1983 because it had a contractual right to recoup unintentional overpayment for past services from sums due for later services. See note 1, supra. Connecticut further asserts that it retained its contractual right of recoupment even though the debtor-in-possession never formally assumed the contract pursuant to § 365 of the Code.(9) Connecticut contends that by demanding

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(9) Section 365 provides, "[T]he trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor." 11 U.S.C.A. § 365(a) (West 1979).

payment under the contract post-petition, the debtor accepted the benefits of the contract and thus also assumed its burdens. See In re Yonkers Hamilton Sanitarium, Inc., 22 B.R. 427, 9 B.C.D. 505 (Bankr. S.D.N.Y. 1982); Ambulance Corp. of America v. Schweiker (In re Ambulance Corp. of America), 27 B.R., 910, 10 B.C.D. 355 (Bankr. E.D.Pa. 1983) (Alternative holding). But see Commonwealth of Massachusetts v. Dartmouth House Nursing Home, Inc. (In re Dartmouth House Nursing Home, Inc.), 24 Bankr. 256, 9 B.C.D. 954 (Bankr. D. Mass. 1982), appeal dismissed, 30 Bankr. 56, 10 B.C.D. 754, 8 C.B.C.2d 728 (Bankr. 1st Cir. 1983).

In NLRB v. Bildisco & Bildisco, -- U.S. --, 104 S. Ct. 1188, 79 L.Ed.2d 482 (1984), the Supreme Court

considered the enforceability of a prepetition collective-bargaining agreement against a chapter 11 debtor where the debtor had accepted the benefits of the contract without having formally assumed it. In holding that the prepetition agreement was not enforceable against the debtor, the Court said:

> If the debtor-in-possession elects to continue to receive benefits from the other party to an executory contract pending a decision to reject or assume the contract, the debtor-in-possession is obligated to pay for the reasonable value of those services, which, depending on the circumstances of a particular contract may be what is specified in the contract. Should the debtor-in-possession elect to assume the executory contract, however, it assume the contract cum onere ... .
> [T]he filing of the petition in bankruptcy means that the collective-bargaining agreement is no longer immediately enforceable, and may never be enforceable again.

Id., -- U.S. --, 104 S.Ct. at 1199, 79

L.Ed.2d at 499. (citations omitted).

The above-quoted language in Bildisco which limits Connecticut's cum onere theory to a formally assumed contract, is broad enough to apply in the present situation. In this case, if a Bildisco theory is applied there is no enforceable agreement between Connecticut and the debtor from which Connectiuct could derive a contractual right of recoupment. Connecticut would therefore be liable for the reasonable value of the debtor's services.

However, even if the agreement between Connecticut and the debtor remained enforceable postpetition without formal assumption, Connecticut still cannot retain the monies due for the March 1983 services. Connecticut argues that its right to recover past overpayments out of amounts due for

current services is a right of recoupment rather than set-off because the right to recover arose out of the same contract as debtor's right of payment for its March 1983 services. Accepting, arguendo, Connecticut's claim that the two rights arise from the same contract, that circumstance is not sufficient to create recoupment. Recoupment requires not only that the defendant's right of recovery and the plaintiff's right of payment arise from the same contract but also that they relate to the same subject matter. T.W. Waterman, A Treatise on the Law of Set-Off, Recoupment and Counterclaim § 468 at 482-83 (2d ed. 1872). The two rights here neither relate to the same subject matter nor arise from the same contract. Debtor's right of payment relates only to its March 1983

services; Connecticut's right of reimbursment relates to prior services under different contracts for the years 1976-1980. Therefore, Connecticut asserts not a right of recoupment but a right to set off a prepetition claim against the debtor against a postpetition obligation to the debtor. This claimed right is contrary to federal bankruptcy law and is, therefore, unenforceable. In re Dartmouth House Nursing Home, Inc., supra, (Right to recover prepetition overpayments from postpetition earnings unenforceable). It is not now necessary to choose between the two theories discussed above since it is only required at this point in the proceedings that it be clear that the plaintiff has stated some enforceable theory of recovery.

V.

POLICY ARGUMENT

Connecticut urges a policy argument upon the court in the following language:

> If bankruptcy law and the Court permitted the trustee to do what he is attempting here, a message would be sent to every nursing home owner in Connecticut "to fill your annual cost reports with whatever claims you want, sit back and pocket illegal Medicaid overpayments, wait for the State's field auditors to catch you, then file in Chapter 11 in Bankruptcy to misuse and abuse the bankruptcy statute so as to prevent the taxpayers from recovering the monies wrongfully taken from them.

Connecticut's Memorandum at 48.

Connecticut's argument is misdirected. If the trustee prevails in this proceeding, the recovery will not go to line the pockets of stockholders of the debtor. Rather, the unpaid administrative expense creditors in the

chapter 11 case may have funds available to compensate them for the services which provided the basis for the $64,010.24 claim against Connecticut.

VI.

CONCLUSION

For the reasons discussed above, Connecticut's motions to dismiss for lack of subject matter jurisdiction and failure to state a claim for relief (treated as a motion for summary judgment) are denied. It is

SO ORDERED.

Dated at Hartford, Connecticut, this 25th day of April, 1984.

/s/ ROBERT L. KRECHEVSKY
UNITED STATES BANKRUPTCY JUDGE

MEMORANDUM AND ORDER OF THE
UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

(Dated June 8, 1984)

In Bankruptcy No. 2-83-00754
Adversary Proceeding No. 2-84-0008

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

EDWARD ZERA,

Debtor

MARTIN W. HOFFMAN, TRUSTEE

Plaintiff

v.

STATE OF CONNECTICUT,
DEPARTMENT OF REVENUE SERVICES

Defendant

APPEARANCES:

MARTIN W. HOFFMAN, ESQ., 410 Asylum Street, Hartford, Connecticut 06103
Attorney for Plaintiff

Jonathon L. Ensign, Assistant Attorney General, State of Connecticut, Department of Revenue Services, P.O. Box 120, Hartford, Connecticut 06109
Attorney for Defendant

MEMORANDUM AND ORDER RE:
DEFENDANT'S MOTION TO DISMISS
COMPLAINT FOR LACK OF SUBJECT MATTER
JURISDICTION AND FAILURE TO STATE
CLAIM UPON WHICH RELIEF
CAN BE GRANTED

KRECHEVSKY, B.J.

I.

ISSUE

The above-captioned adversary proceeding, an action to recover an allegedly preferential transfer, was brought by Martin W. Hoffman (trustee) against the State of Connecticut, Department of Revenue Services (Revenue), pursuant to 11 U.S.C. § 547(b).[1] The matter presently before

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(1) Section 547 (b) provides:

> Except as provided in subsection (c) of this section, the trustee may avoid any transfer of property of the debtor --
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

the court is Revenue's motion to dismiss the trustee's complaint for

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> (3) made while the debtor was insolvent;
>
> (4) made --
>
> > (A) on or within 90 days before the date of the filing of the petition; or
> >
> > (B) between 90 days and one year before the date of the filing of the petition, if such creditor, at the time of such transfer --
> >
> > (i) was an insider; and
> >
> > (ii) had reasonable cause to believe debtor was insolvent at the time of such transfer; and
>
> (5) that enables such creditor to receive more than such creditor would receive if --
>
> > (A) the case were a case under chapter 7 of this title;
> >
> > (B) the transfer had not been made; and
> >
> > (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C.A. § 547(b) (West 1979).

lack of subject-matter jurisdiction and for failure to state a claim upon which relief can be granted, see Fed. R. Civ. P. 12(b)(1), (6) (made applicable to this adversary proceeding by Fed. R. Bankr. P. 7012(b)). Revenue's motion presents the issue of whether or not, as an agency of the State of Connecticut, its common-law sovereign immunity and/or the immunity it enjoys pursuant to the Eleventh Amendment of the United States Constitution (2) require

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(2) The Eleventh Amendment provides:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State or by Citizens or Subjects of any Foreign State.

U.S. Const. Amend. XI, U.S.C.A. (West 1972). The Eleventh Amendment also bars suits against a state by its own citizens. Hans v. Louisiana, 134 U.S. 1, 10 S. Ct. 504, 33 L.Ed. 842 (1890).

the dismissal of the complaint. The history behind this proceeding as gleaned from the pleadings and the memoranda filed by the parties is as follows.

II.

BACKGROUND

Prior to the filing of his chapter 7 petition, Edward Zera (debtor) did business as Alyear Maintenance Service. In the operation of his business, debtor incurred a debt to Revenue for sales and use taxes for the quarters of June 30, 1981 through December 31, 1982, a renewal fee due in July, 1983, and penalties and interest. Allegedly also as a result of the operation of his business over a similar period, debtor owes the Connecticut Department of Labor - Unemployment Compensation

Division (Labor) for unpaid unemployment compensation taxes.

On September 22, 1983, pursuant to Conn. Gen. Stat. § 12-35, Revenue filed a tax warrant against debtor for $1,977.00 for the sales and use taxes, fees, penalties and interest. An independently-employed service officer served this warrant on or about October 3, 1983, upon Pioneer Systems as garnishee. Pioneer Systems paid over to the officer the $1,977.00 due Revenue and a $123.62 service fee due the officer.

Debtor filed his chapter 7 petition on October 7, 1983. The Notice of First Meeting of Creditors, sent on October 11, 1983, informed creditors that debtor's schedules indicated that there would be no assets

from which a dividend could be paid[3] and no claims need be filed until further notice. On October 28, 1983, Labor filed a proof of claim against the estate for $1,139.69 for unpaid unemployment compensation taxes, later amended to $1,002.91. The trustee filed his complaint against Revenue for $2,100.62 on January 5, 1984.

II.

ARGUMENTS OF THE PARTIES

Revenue argues that the common law sovereign immunity and/or the Eleventh Amendment immunity it enjoys as an agency of the State of Connecticut require the dismissal of the suit

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(3) Debtor's amended schedules show assets of $4,500.00, exemptions of $4,400.00, secured debts of $5,195.67 and unsecured debts without priority of $9,585.62 and unsecured debts with priority of $8,469.16. Labor was scheduled as the holder of a priority claim of $1,047.48.

against it for money damages. It is well-settled that an unconsenting State cannot be sued in federal court for money damages unless Congress has explicitly authorized such a suit. Edelman v. Jordan, 415 U.S. 651, 94 S. Ct. 1347, 49 L.Ed.2d 662 (1974). The trustee argues that in 11 U.S.C. §106[4] Congress authorized a suit of this type against a State. He claims that § 106(a) applies because Labor filed

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(4) Section 106, captioned "Waiver of sovereign immunity", provides:

> (a) A governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which such governmental unit's claim arose.
>
> (b) There shall be offset against an allowed claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.

a claim against the estate, together Labor and Revenue constitute one "governmental unit",[5] the State of Connecticut (Connecticut), and the

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(c) Except as provided in subsections (a) and (b) of this section and notwithstanding any assertion of sovereign immunity --

(1) a provision of this title that contains "creditor", "entity", or "governmental unit" applies to governmental units; and

(2) a determination by the court of an issue under such a provision binds governmental units.

11 U.S.C.A. § 106 (West 1979).

(5) "Governmental unit" is a defined term and means United States; State; Commonwealth; District; Territory, municipality; foreign state; department, agency, or instrumentality of the United States, a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government... .

11 U.S.C.A. § 101(21) (West 1979).

estate's claim against Connecticut "arose out of the same transaction or occurrence out of which such governmental unit's claim arose," 11 U.S.C.A. § 106(a)(West 1979). Furthermore, the trustee argues, § 106(c) expressly permits preference proceedings against a State agency such as Revenue, regardless of its failure to file a claim against the estate.

Revenue counters that § 106, addressed to "sovereign immunity," was not intended by Congress to affect the Eleventh Amendment immunity. Even if Congress had so intended, Revenue argues, Congress could not, pursuant to Bankruptcy Power,[6] abrogate the Eleventh

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(6) The Congress shall have Power ... to establish ... uniform Laws on the subject of Bankruptcies throughout the United States ... .

U.S. Const. Art. I, § 8, U.S.C.A. (West 1968).

Amendment immunity of a State which did not subsequently consent in some way to federal suit. As to its common-law sovereign immunity, Revenue says that § 106(a) does not apply because there are two governmental units here, not one, and, in any event, the claim of the estate and Labor's claim do not arise out of the same transaction as required by the terms of § 106(a). Finally, Revenue insists that § 106(c) does not waive its common-law sovereign immunity as to a suit for money damages because to so construe § 106(c) would render § 106(a) and (b) surplussage. I will consider the § 106(a) and § 106(c) issues separately.

III.

SECTION 106(a)

The theory behind § 106(a) was explained in the identical

congressional committee reports which accompanied the original drafts of § 106(a) as contained in H.R. 8200 and S. 2266 (7) and was set forth as follows:

> [T]he filing of a proof of claim against the estate by a governmental unit is a waiver by that governmental unit of sovereign immunity with respect to compulsory counterclaims, as defined in the Federal Rules of Civil Procedure, that is, counterclaim arising out of the same transaction or occurrence. The governmental unit cannot receive distribution from the estate without subjecting itself to any liability it has to the estate within the confines of a compulsory counterclaim rule. Any other result would be one-sided. The counterclaim by the estate against the governmental unit is without limit.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 317 (1977); S. Rep. No. 989, 95th

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(7) For a detailed history of the development of § 106, see Hoffman v. State of Connecticut (Willington Convalescent Home, Inc.), 11 B.C.D. 1039 (Bankr. D. Conn. 1984), appeal docketed, No. H-84-636 (D. Conn. June 5, 1984).

Cong., 2d Sess. 219 (1978) reproduced in Collier on Bankruptcy, App. 2 § II, 3 § V) (15th ed. 1984).

The Second Circuit has considered certain factors appropriate indicators of the compulsory nature of a counterclaim:

> (1) identity of facts between original claim and counterclaim; (2) mutuality of proof; (3) logical relationship between original claim and counterclaim. Although these factors or test may be indicative in one sense or another of the compulsory character of a counterclaim, no one of them is conclusive, and should not be relied on exclusively.

Federman v. Empire Fire and Marine Ins. Co., 597 F.2d 798, 812 (2d Cir. 1979). See also Manway Const. v. Housing Auth. of City of Hartford, 711 F.2d 501 (2d Cir. 1983) ("[T]here must have been at least a common nexus of fact - a transactional relationship - between the claims;" ancillary jurisdiction

case). Although the sales and use taxes and unemployment compensation taxes were incurred by debtor in the operation of his business over similar time periods, I cannot conclude that there is an adequate factual overlap or a clear logical connection between the trustee's suit to recover an involuntary payment of sales and use taxes from Revenue and Labor's claim for unpaid unemployment compensation taxes. The transactions which give rise to each type of tax liability are different. The estate's preference claim is not, therefore, a compulsory counterclaim to Labor's claim. Consequently, even accepting, arguendo, the trustee's contention that there is but one governmental unit, Connecticut, present here, the trustee's § 106(a) theory cannot prevail.

IV.

SECTION 106(c)

In Hoffman v. State of Connecticut (In re Willington Convalescent Home, Inc.), supra, I considered and rejected the very arguments concerning § 106(c) which Revenue raises here. In Willington, the chapter 7 trustee had sued Connecticut for payment for postpetition, preconversion services rendered Connecticut by the chapter 11 debtor as a state-licensed skilled nursing facility and a provider-participant in the Connecticut Medicaid program. Id. at 1040. I held that the plain language of § 106(c) provides that a governmental unit such as a State or a State agency is bound by the Code provision which states, "[A]n entity that owes a debt that is

property of the estate and that is matured ... shall pay such debt to ... the trustee," 11 U.S.C.A. § 542(b)(West 1979), and required payment of the account then in question. Willington at 1042. I held that this construction of § 106(c) did not render § 106(a) and (b) surplussage because there are Code sections not within the terms of § 106(c)(1), e.g., 11 U.S.C. §§ 545, 549.(8) Moreover, even if surplussage would result from the Willington construction, I held the presumption against surplussage must give way before the strong showing in the legislative history behind § 106(c) that the subsection was intended to be so construed. Willington at 1042-44.

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(8) In addition, not all debts owed by a State which are property of the estate are necessarily "matured", e.g., unliquidated tort claims may not be within the scope of § 542(b) or § 106(c)(1).

Having decided that in § 106(c) Congress clearly and unambiguously answered in the affirmative the question of whether the State may be sued, the common-law sovereign immunity question, I then held that in 28 U.S.C. § 1471(b),(9) passed contemporaneously with § 106(c) as part of the Bankruptcy Reform Act of 1978, Congress provided that the liability created by § 106(c) could be enforced in federal court and

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(9) Section 1471(b) of Title 28 of the United States Code provides:

> Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11 or arising in or related to cases under title 11.

28 U.S.C.A. § 1471(b) (West 1984 Supp.).

thus answered the Eleventh Amendment question of where the State could be sued. Willington at 1044. Having decided that Congress intended to abrogate the Eleventh Amendment in § 106(c), I held that Congress could abrogate a state's constitutional immunity from suit pursuant to the Bankruptcy Power. Willington at 1044-45. In the light of the critique of Willington which Revenue has included in its reply memorandum of May 9, 1984, I have re-examined the rationale of Willington. I see no reason, at this time, to disturb the above-stated holdings.

This proceeding differs significantly from Willington only in that the trustee's complaint is based on § 547(b) rather than § 542(b). Therefore, an analysis of the interrelation-

ship between § 106(c), § 547(b) and § 550(a) is required.

As set forth at note 4, supra, § 106(c)(1) makes applicable to a § 101(21) governmental unit, such as a State or its agency, any provision of this title that contains 'creditor' [or] 'entity'... ." As set forth at note 1, supra, § 547(b) makes avoidable otherwise preferential transfers "to or for the benefit of a creditor ... ." Section 550 governs the liability of a transferee of an avoided transfer and provides:

> [T]o the extent that a transfer is avoided under section ... 547 ... of this title, the trustee may recover for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property from --
>
> (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made ... . "

11 U.S.C. § 550(a) (West 1979). Therefore, a § 547 preference, recoverable under § 550(a)(1), is within the ambit of § 106(c).

The history behind §§ 106(c) and 547(b) demonstrates that § 547(b) transfers to § 101(21) governmental units are to be treated no differently than similar transfers to non-governmental creditors. The original draft bankruptcy bills considered by the Hosue and Senate, H.R. 8200, 95th Cong., 1st Sess. (1977) (reproduced in Collier on Bankruptcy, App. 3 § III (15th ed. 1984), and S. 2266, 95th Cong., 2d Sess. (1978) (reproduced in Collier, App. 3 § VII), contained only subsections (a) and (b) of § 106 as now enacted.[10] That narrow approach to the

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(10) See note 7, supra.

application of the Bankruptcy Code to § 101(21) governmental units was narrowed further by the original Senate draft of § 547(b). The Senate draft of § 547(b) excluded from the range of voidable preferences "debt[s] for which payment is required under the revenue laws of a governmental unit," S. 2266 § 547(b)(2). When the House and Senate considered the conference committee amendment to the draft version of § 106, the amendment ultimately enacted as § 106(c), the conference committee report circulated with that amendment specifically mentioned as an example of the application of § 106(c) that "section 106(c) permits a trustee or debtor in possession to assert avoiding powers under title 11 against a governmental unit," 124 Cong Rec. H. 11091 (Sept. 28, 1978) (remarks of Rep.

Edwards); S. 17407 (October 6, 1978) (remarks of Sen. DeConcini) (reproduced in Collier, App. 3 §§ IX at IX-90, X at X-16). At the same time Congress adopted § 106(c), it rejected the Senate version of § 547(b)(2) and included tax debts to governmental units within the scope of § 547(b) preferences. The conference committee report which was circulated with § 547(b) as adopted commented:

> Section 547 (b)(2) of the House amendment adopts a provision contained in the House bill and rejects an alternative contained in the Senate amendment relating to the avoidance of a preferential transfer that is payment of a tax claim owing to a governmental unit. As provided, section 106(c) of the House amendment overrules contrary language in the House report with the result that the Government is subject to avoidance of preferential transfers.

124 Cong. Rec. H. 11097 (Sept. 28, 1978) (remarks of Rep. Edwards);

S. 17414 (Oct. 6, 1978) (remarks of Sen. DEeConcini) (reproduced in Collier, Appendix 3 § IX at IX-103, § X at X-29).

Because of the plain language of § 106(c) and the supporting legislative history, courts have had little difficulty in construing § 106(c) to permit recovery of § 547(b) preferences from governmental units which possess the common-law immunity but which do not possess the Eleventh Amendment immunity. See Ellenberg v. Dekalb County (In re Maytag Sales and Service, Inc.), 23 Bankr. 384, 9 B.C.D. 908, 7 C.B.C.2d 405 (Bankr. N.D. Ga. 1982) (§106(c) waives sovereign immunity of a Georgia county in a preference action even had it not filed a related claim); Matter of Community Hosp. of Rockland

County, 15 Bankr. 785, 8 B.C.D. 540, 5 C.B.C.2d 895 (Bankr. S.D.N.Y. 1981) (§106(c) waives I.R.S.'s defense of sovereign immunity to preferenc actions); Remke, Inc. v. United States (Matter of Remke, Inc.), 5 Bankr. 299 (Bankr. E.D. Mich. 1980) (same). The holding of Willington on the Eleventh Amendment issue is applicable to this § 547 proceeding. The result in Maytag Sales and Service, supra, Community Hosp. of Rockland County, supra, and Remke, supra, does not differ because the defendant ordinarily enjoys immunity from suit in federal court.

V.

CONCLUSION

For the reasons discussed above, Revenue's motion to dismiss this proceeding for lack of subject-matter jurisdiction and for failure to state a

claim upon which relief can be granted is hereby denied. It is

SO ORDERED:

Dated at Hartford, Connecticut, this 8th day of June, 1984.

/s/ROBERT L. KRECHEVSKY
UNITED STATES BANKRUPTCY JUDGE

CONSTITUTIONAL PROVISIONS

Eleventh Amendment to the United States Constitution

The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

STATUTORY PROVISIONS

11 U.S.C. § 101(26)

(26) "governmental unit" means United States; State; Commonwealth;

District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States (but not a United States trustee while serving as a trustee in a case under this title), a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government;

11 USCS § 106.

(a) A governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of

which such governmental unit's claim arose.

(b) There shall be offset against an allowed claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.

(c) Except as provided in subsections (a) and (b) of this section and notwithstanding any assertion of soveriegn immunity--

(1) a provision of this title that contains "creditor", "entity", or "governmental unit" applies to governmental units; and

(2) a determination by the court of an issue arising under such a provision binds governmental units.

11 USCS § 542.

(a) Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

(b) Except as provided in subsection (c) or (d) of this section, an entity that owes a debt that is property of the estate and that is

matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee, except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor.

(c) Except as provided in section 362(a)(7) of this title, an entity that has neither actual notice nor actual knowledge of the commencement of the case concerning the debtor may transfer property of the estate, or pay a debt owing to the debtor, in good faith and other than in the manner specified in subsection (d) of this section, to an entity other than the trustee, with the same effect as to the entity making such transfer or payment as if the case

under this title concerning the debtor had not been commenced.

(d) A life insurance company may transfer property of the estate or property of the debtor to such company in good faith, with the same effect with respect to such company as if the case under this title concerning the debtor had not been commenced, if such transfer is to pay a premium or to carry out a nonforfeiture insurance option, and is required to be made automatically, under a life insurance contract with such company that was entered into before the date of the filing of the petition and that is property of the estate.

(e) Subject to any applicable privilege, after notice and a hearing, the court may order an attorney, accountant, or other person that holds recorded information, including books, documents, records, and papers, relating to the debtor's property or financial affairs, to turn over or disclose such recorded information to the trustee.

11 U.S.C. § 547(b).

(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property--

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made--

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if--

(A) the case were a case under Chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 USCS § 550.

(a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the

property transferred, or, if the court so orders, the value of such property, from--

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or

(2) any immediate or mediate transferee of such initial transferee.

(b) The trustee may not recover under section (a)(2) of this section from--

(1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or

(2) any immediate or mediate good faith transferee of such transferee.

(c) The trustee is entitled to only a single satisfaction under subsection (a) of this section.

(d)(1) A good faith transferee from whom the trustee may recover under subsection (a) of this section has a lien on the property recovered to secure the lesser of--

(A) the cost, to such transferee, of any improvement made after the transfer, less the amount of any profit realized by or accruing to such transferee from such property; and

(B) any increase in the value of such property as a result of such improvement, of the property transferred.

(2) In this subsection, "improvement" includes--

(A) physical additions or changes to the property transferred;

(B) repairs to such property;

(C) payment of any tax on such property;

(D) payment of any debt secured by a lien on such property that is superior or equal to the rights of the trustee; and

(E) preservation of such property.

(e) An action or proceeding under this section may not be commenced after the earlier of--

(1) one year after the avoidance of the transfer on account of which recovery under this section is sought; or

(2) the time the case is closed or dismissed.

28 USCS § 1334.

(a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11 [11 USCS §§ 101 et seq.].

(b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11 [11 USCS §§ 101 et seq.], or arising in or related to cases under title 11 [11 USCS §§ 101 et seq.].

(c)(1) Nothing in this section prevents a district court in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 [11 USCS §§ 101 et

seq.] or arising in or related to a case under title 11 [11 USCS §§ 101 et seq.].

(2) Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 [11 USCS §§ 101 et seq.] but not arising under title 11 [11 USCS §§ 101 et seq.] or arising in a case under title 11 [11 USCS §§ 101 et seq.], with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely

adjudicated, in a State forum of appropriate jurisdiction. Any decision to abstain made under this subsection is not reviewable by appeal or otherwise. This subsection shall not be construed to limit the applicability of the stay provided for by section 362 of title 11, United States Code [11 USCS § 362], as such section applies to an action affecting the property of the estate in bankruptcy.

(d) The district court in which a case under title 11 [11 USCS §§ 101 et seq.] is commenced or is pending shall have exclusive jurisdiction of all of the property, wherever located, of the

debtor as of the commencement of such case, and of the property of the estate.

28 USCS § 157.

(a) Each district court may provide that any or all cases under title 11 [11 USCS §§ 101 et seq.] and any or all proceedings arising under title 11 [11 USCS §§ 101 et seq.] or arising in or related to a case under title 11 [11 USCS §§ 101 et seq.] shall be referred to the bankruptcy judges for the district.

Supreme Court, U.S.
FILED
OCT 6 1988
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CLERK

No. 88-412 (2)

In The
Supreme Court Of The United States

OCTOBER TERM, 1988

IN RE WILLINGTON CONVALESCENT HOME, INC., DEBTOR

MARTIN W. HOFFMAN, TRUSTEE
Petitioner

v.

STATE OF CONNECTICUT, DEPARTMENT OF INCOME MAINTENANCE,
STATE OF CONNECTICUT, DEPARTMENT OF HEALTH SERVICES
and
UNITED STATES OF AMERICA
Respondents

IN RE EDWARD ZERA, DEBTOR

MARTIN W. HOFFMAN, TRUSTEE
Petitioner

v.

STATE OF CONNECTICUT, DEPARTMENT OF REVENUE SERVICES
and
UNITED STATES OF AMERICA
Respondents

BRIEF IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED

1. Whether Congress in 11 U.S.C. § 106(c) intended to abrogate the States' Eleventh Amendment immunity from bankruptcy actions seeking money damages?

2. Whether Congress has the constitutional authority under the bankruptcy clause to abrogate the States' Eleventh Amendment immunity from bankruptcy actions seeking money damages?

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STATEMENT OF THE CASE

The petition for certiorari arises from two separate bankruptcy cases that the Court of Appeals decided jointly. These cases have some issues in common, but these issues do not merit review. In addition, one of the cases presents separate grounds for nonreviewability.

1. *In re Willington Convalescent Home, Inc.* involves a nursing home facility that participated in the Connecticut Medicaid Program. *See* Pet. App. at A28–A33. Willington agreed to provide nursing care services to indigent patients eligible under Title XIX at a specific per diem rate of compensation. The State determined the per diem rate from annual cost reports submitted by Willington.

Under the program the State initially accepts at face value the cost data submitted by nursing homes such as Willington, but then conducts subsequent field audits to verify that the costs claimed are legitimate. If costs are found to have been improperly or falsely claimed, the State is obligated to adjust the per diem rate retroactive to the applicable rate year and recoup the amount of Medicaid overpayment from whatever monthly payments may be due and owing to the facility for current patient care. Unless or until the field audit has taken place, there is no final determination that the monthly Medicaid payments in fact belong to the nursing home at all. If the nursing home disputes the findings made in the field audit, it may seek an administrative hearing within the Department of Income Maintenance, and then seek judicial review by appeal to the Connecticut Superior Court.

In this case Willington submitted sworn cost reports for the years 1976 to 1980 that claimed real property costs of $294,007.00. On the basis of these reports, the State set per diem Medicaid rates for those years. A subsequent field audit disclosed, however, that Willington's actual costs were only $22,500.00. As a result of its false reports, Willington had received substantial Medicaid overpayments for these five rate

years. Accordingly, the Commissioner of the Connecticut Department of Income Maintenance issued two Medicaid rate decisions in 1982 adjusting downward Willington's per diem rates for the years 1976 and 1980, and 1977 through 1979, respectively. The effect of these decisions was to commence the recoupment of the substantial Medicaid overpayments Willington had received.

Willington did not contest the recomputation of its rates for 1976 and 1980, but did request administrative review of the 1977 through 1979 decision. Soon thereafter, however, Willington moved to postpone the administrative hearing indefinitely. Meanwhile, in June, 1982, shortly after recoupment of the past Medicaid overpayments had commenced, Willington filed a Chapter 11 petition in bankruptcy.[1]

While in bankruptcy Willington continued to participate in the Medicaid program and to receive monthly checks. The State sought to and did recoup a modest amount of the past Medicaid overpayment from the monthly payments due Willington for on-going patient care. In April, 1983, Willington shut down permanently, still owing the State $121,408.00.

In July, 1983, the bankruptcy court converted the case from Chapter 11 to Chapter 7 and appointed the petitioner as Trustee. The Trustee then filed the present adversary complaint in the nature of a turnover proceeding under 11 U.S.C. § 542(b) against the State seeking payment of $64,010.24 for services rendered to Medicaid patients by Willington during March, 1983. The State at no point during these proceedings filed a proof of claim, scrupulously avoiding doing anything that could be construed as a waiver of its Eleventh Amendment immunity.

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[1] This result is not uncommon. The pattern in the Connecticut nursing home industry, and the actual practice in this case, is for the owners of the nursing home entity to form a partnership to own assets such as land, buildings, and furnishings, and to form a corporation to constitute the nursing home entity. In that way the corporation can file for bankruptcy to discharge its debts, while the owners can remain out of bankruptcy and retain the assets.

2. In *Zera*, a Connecticut business operated by Edward Zera owed the State Department of Revenue Services sales and use taxes, and associated fees. *See* Pet. App. at A73–A75. In September, 1983, the Revenue Department issued a tax warrant, which resulted in a payment of $2,100.62 to the State.

Zera filed for Chapter 7 bankruptcy relief on October 7, 1983 and the bankruptcy court appointed the petitioner as Trustee. The Trustee filed an adversary complaint against the Department seeking to avoid the $2,100.62 payment as a preference under 11 U.S.C. § 547(b) and to recover monies transferred pursuant to 11 U.S.C. § 550(a). Although the Connecticut Department of Labor filed an unrelated proof of claim against Zera, the Department of Revenue Services filed no proof of claim.

3. The State essentially concurs with the petitioner's recitation of the subsequent procedural events in both cases. *See* Pet. at 9–13. It is important to add, however, that in both cases the State consistently argued that, even assuming Congress intended to abrogate the State's Eleventh Amendment immunity pursuant to 11 U.S.C. § 106(c), it had no constitutional power to do so under the bankruptcy clause of Article I, § 8. Because the District Court and the Court of Appeals found that Congress did not intend to abrogate the Eleventh Amendment pursuant to § 106(c), neither court reached this constitutional issue. Pet. App. at A8, A69–A70, A92.

REASONS FOR DENYING THE PETITION

1. Although the petitioner refers to a "direct conflict" between the decision below and that of the Seventh Circuit in *In re McVey Trucking Co., Inc.*, 812 F.2d 311 (7th Cir.), *cert. denied*, 108 S.Ct. 227 (1987), such a statement requires qualification. While it is true that the Second and Seventh Circuits disagreed concerning whether Congress intended to abrogate the States' Eleventh Amendment immunity in 11 U.S.C. § 106(c), the Seventh Circuit candidly admitted that the result it reached "may appear to be at odds with the expansive language that the Supreme Court has often employed in discussing the Eleventh Amendment and sovereign immunity." 812 F.2d at 327–28.[2] Further, the Seventh Circuit devoted the bulk of its opinion to its conclusion that Congress has the constitutional power under the bankruptcy clause to abrogate the Eleventh Amendment, *id.* at 314–23, an issue that the Second Circuit did not reach. Thus on this issue no conflict at all exists between the two Circuits.

In any event, a partial conflict between two Circuits on the statutory issue in this case does not provide an adequate basis for a discretionary grant of certiorari. The interpretation of § 106(c) is a relatively novel issue in the Courts of Appeals. Further development of the issue by the Circuits may produce a consensus, presumably in line with the decision below. In that event, there would be no real conflict for this Court to resolve. At this point, then, the issue is simply not ripe for a grant of certiorari.

2. The petitioner's alternate contention that the decision below conflicts with this Court's decision in *Fitzpatrick v. Bitzer*, 427 U.S. 455 (1976), is completely inaccurate. The question in *Fitzpatrick* was again the constitutional one of whether

[2] Indeed, the Seventh Circuit itself had only several years earlier held that the Eleventh Amendment barred an action in bankruptcy court by physicians seeking Medicaid funds from the State. *In re Friendship Medical Center, Ltd.*, 710 F.2d 1297, 1299–1301 (7th Cir. 1983).

Congress has the power — in that case under the Fourteenth Amendment — to abrogate the Eleventh Amendment. Since, as discussed, the court below did not reach that issue, no conflict exists with *Fitzpatrick*.[3]

3. Given that the State has raised the constitutional issue in the courts below, the petitioner, in order to obtain a reversal, would have to prevail on both the statutory and the constitutional issue. But this case is a singularly inappropriate one to address the constitutional issue of whether Congress under the bankruptcy clause has the power to abrogate the Eleventh Amendment. For neither the Court of Appeals nor the District Court reached this issue. This Court should not decide such a complex issue on a silent record.

4. Even aside from the possibility of affirmance on constitutional grounds, the decision below was undoubtedly correct. This Court has stated that it will find a Congressional waiver of immunity only when Congress makes its intention "unmistakenly clear in the language of the statute." *Atascadero State Hospital v. Scanlon*, 473 U.S. 234, 242 (1985). There is nothing in the language of § 106(c) — the key provision of which provides that "a determination by the court of an issue arising under such a provision binds governmental units" — to support the proposition that § 106(c) unequivocally waives the States' constitutional immunity from actions for money damages. Indeed, § 106(c) does not even mention money damages or any similar term. The conclusion of the Court of Appeals that § 106(c) "waives sovereign immunity only to the extent necessary for the bankruptcy court to

[3] The petitioner attempts to redefine *Fitzpatrick* as a statutory case addressing the issue of whether Congress intended to waive the Eleventh Amendment under Title VII of the Civil Rights Act, 42 U.S.C. § 2000e *et seq.*, and then suggests that the decision on this issue is at odds with the decision below in the present case. In actuality, however, the statutory issue in *Fitzpatrick* was resolved in the lower courts and not contested in this Court. 427 U.S. at 450–51. In any event, Title VII and § 106 of the Bankruptcy Code are two different statutes with different legislative histories. *See* 427 U.S. at 449 n.2.

determine a state's rights in the debtor's estate," Pet. App. at A13, is much truer to the language of § 106(c) that "a *determination* by the court of an *issue* arising under such a provision binds governmental units." (Emphasis added.) Such a conclusion is also truer to the legislative history, which suggests that the primary purpose of § 106(c) was to codify the authority of the federal courts to make dischargeability or similar determinations against the government even when the government had filed no proof of claim. *See* Pet. App. at A13–A15. In short, the language and legislative history of § 106(c) does not make "unmistakenly clear" anything other than that federal courts may make prospective declarations of federal law against governmental units. *Atascadero State Hospital v. Scanlon, supra.*[4]

5. There are several separate grounds for nonreviewability in *Willington*, thus making the entire petition inappropriate for review. First, the District Court invoked as an alternative ground the theory, accepted by many other courts, that Medicare and Medicaid agencies have the contractual right to recoup from post-bankruptcy monthly payment checks any pre-bankruptcy past overpayments. *See, e.g., In re B&L Oil Co.*, 782 F.2d 155, 157 (10th Cir. 1986); *Lee v. Schweiker*, 739 F.2d 870, 875–76 (3rd Cir. 1984). The District Court specifically found:

> However, should the Court of Appeals for the Second Circuit or the United States Supreme Court conclude that the bankruptcy court did properly assert jurisdiction over the trustee's claim, it is found — for essentially the reasons given in the Brief and reply [sic] Brief of the Appellants — that the terms of Willington's contract with Connecticut entitled the state

[4] Contrary to the petitioner's contention, the court below did analyze other sections of the Bankruptcy Code, such as 11 U.S.C. §§ 542(b) and 547(b), to which § 106(c) relates. *See* Pet. at 21, 22; Pet. App. at A17–A18.

> to recoup past overpayments to Willington by withholding the funds due for services provided in March, 1983.

Pet. App. at A70–A71. The Court of Appeals left this finding undisturbed and the petitioner has not challenged it in this Court. Thus it appears that there exist independent, alternate grounds for the decision below in *Willington* and that the petitioner has merely presented this Court with an academic question.

Second, the trustee in *Willington* remains free to pursue the state administrative remedies for challenging rate determinations that he has so far chosen to bypass. The State has never attempted to foreclose these remedies. The availability of these state administrative remedies makes it entirely unnecessary for this Court to address the scope of the Trustee's power to sue the State for Medicaid payments in bankruptcy court.

CONCLUSION

For the foregoing reasons, this Court should deny the petition for certiorari.

Respectfully submitted.

Connecticut Department of
Income Maintenance
Connecticut Department of
Health Services
Connecticut Department of
Revenue Services

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Supreme Court, U.S.
FILED
DEC 7 1988
JOSEPH F. SPANIOL, JR.

No. 88-412

In the Supreme Court of the United States

OCTOBER TERM, 1988

MARTIN W. HOFFMAN, TRUSTEE, PETITIONER

v.

STATE OF CONNECTICUT,
DEPARTMENT OF INCOME MAINTENANCE, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

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QUESTION PRESENTED

Whether Section 106(c) of the Bankruptcy Code (11 U.S.C.) permits a bankruptcy trustee to bring an action against a State in federal bankruptcy court seeking retroactive monetary relief.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-19) is reported at 850 F.2d 50. The opinion of the district court in *In re Willington Convalescent Home, Inc.* (Pet. App. A20-A71) is reported at 72 Bankr. 1002. The opinion of the district court in *In re Edward Zera* (Pet. App. A72-A97) is reported at 72 Bankr. 997. The Memorandum and Order of the bankruptcy court in *In re Willington Convalescent Home, Inc.* (Pet. App. A98-A143) is reported at 39 Bankr. 781. The opinion of the bankruptcy court in *In re Edward Zera* (Pet. App. A144-A185) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on June 15, 1988. The petition for a writ of certiorari was

filed on September 7, 1988. The jurisdiction of this court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISION INVOLVED

11 U.S.C. 106 provides:

> (a) A governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which such governmental unit's claim arose.
>
> (b) There shall be offset against an allowed claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.
>
> (c) Except as provided in subsections (a) and (b) of this section and notwithstanding any assertion of sovereign immunity
>
> (1) a provision of this title that contains "creditor", "entity", or "governmental unit" applies to governmental units; and
>
> (2) a determination by the court of an issue arising under such a provision binds governmental units.

STATEMENT

Petitioner, Martin W. Hoffman, is the trustee in two unrelated bankruptcy cases, *In re Willington Convalescent Home, Inc.*, Debtor, No. 2-82-00508, and *In re Edward Zera*, Debtor, No. 2-83-00754, pending in the United States Bankruptcy Court for the District of Connecticut. In each case, he commenced adversary proceedings in the bankruptcy court against the State of Connecticut seeking money damages. The court of appeals affirmed the district court's dismissal for lack of jurisdiction, thus rejecting the bankruptcy court's finding that 11 U.S.C. 106(c) authorizes trustees to bring suits for money damages against governmental units.

1. The Willington Convalescent Home, Inc., was a nursing home operator which participated in the Connecticut Medicaid program. After a field audit in 1980 determined that Willington had overstated its real property costs, resulting in excess reimbursements by the State for five years, the State began recouping these past overpayments from its current payments to Willington. In 1982, Willington filed a petition under Chapter 11 of the Bankruptcy Code. It continued to operate and participate in the Medicaid program until it closed in April 1983; at that time it still owed Connecticut $121,408. Although the State did not file a proof of claim in the bankruptcy court, it refused to pay Willington $64,010.24 for Medicaid services rendered in March 1983. After Willington's Chapter 11 case was converted to Chapter 7, petitioner was appointed trustee and filed a turnover action under 11 U.S.C. 542(b) (see Pet. App. A6) seeking to recover the $64,010.24 from the State. The State moved to dismiss for lack of jurisdiction. *Id.* at A5-A6.

Edward Zera, who operated a maintenance service, incurred liability to Connecticut for overdue taxes and a renewal fee. Connecticut's Department of Revenue Services issued a tax warrant, which resulted in payment of $2,100.62 to the State. After Zera filed for bankruptcy, petitioner was appointed trustee and sought to avoid the $2,100.62 payment as a preference (see 11 U.S.C. 547(b)) and to recover the money paid to Connecticut (see 11 U.S.C. 550(a)). The State again moved to dismiss for lack of jurisdiction. Pet. App. A6-A7.

2. In each case, the bankruptcy court denied the State's motion to dismiss, finding that it had jurisdiction

over the trustee's action under Section 106(c). In Willington's case, the court first noted that Section 106(c) provides that "notwithstanding any assertion of sovereign immunity (1) a provision of this title that contains 'creditor', 'entity', or 'governmental unit' applies to governmental units; and (2) a determination by the court of an issue arising under such a provision binds governmental units." The court then noted that Section 542(b), the turnover provision invoked by petitioner to compel Connecticut to turn over the $64,010.24, applies to any "entity," one of the triggering words listed in Section 106(c)(1). From that, and without any discussion of Section 106(c)(2), the court concluded that "Congress has expressly provided that a State is bound by a court judgment ordering it to make payment of a matured debt and a defense of sovereign immunity against a suit brought by a trustee is unavailing" (Pet. App. A115-A116).

Having concluded that the State was subject to suit, the court went on to consider whether, in light of the Eleventh Amendment, it was subject to suit in federal court. The court stated that Section 106(c) "clearly and unambiguously" subjects states to turnover actions, and further noted that the Code's jurisdictional provisions and general policies showed that Congress intended a bankrupt estate to "have the benefit of bringing all its litigation in the single federal forum" (Pet. App. A127-A128). The court accordingly concluded that "Congress not only waived the State's common-law sovereign immunity but intended that such waiver be enforced in the federal courts" (*id.* at A129). The court further concluded that Congress has the power under the Bankruptcy Clause, Art. I, § 8, Cl. 4, to abrogate a state's Eleventh Amendment immunity (Pet. App. A135).

In Zera's case, the court noted that the "proceeding differs significantly from *Willington* only in that the trustee's

complaint is based on § 547(b) [the preference provision] rather than § 542(b) [the turnover provision]" (Pet. App. A161). However, since the preference provision applies to "creditor[s]," another triggering word under Section 106(c)(1), the court concluded that the State was also subject to an action seeking to avoid a preferential transfer (Pet. App. A166).

3. Connecticut appealed both cases to the United States District Court for the District of Connecticut, arguing that Section 106(c) did not subject it to suit, and, if it did, that it was unconstitutional. The district court certified to the Attorney General, pursuant to 28 U.S.C. 2403, that the constitutionality of an Act of Congress had been drawn into question, and the United States intervened. The district court then reversed the bankruptcy court's decisions.

In Willington's case, the court agreed with the United States that, properly construed, Section 106(c) has a limited purpose: it " 'subjects sovereign units to bankruptcy jurisdiction and authority when the bankruptcy court acts pursuant to a specific grant of authority where relief of an injunctive and declaratory nature can be imposed or when the dispute arises within the bankruptcy court's in rem jurisdiction' " (Pet. App. A64-A65 n.22 (quoting U.S. Br. 9)). That reading is based on the language of Section 106(c)(2), which, unlike Sections 106(a) and (b), does not authorize "claims" but instead provides that "a determination by the court of an issue arising under such provision [*i.e.*, a provision containing one of the triggering terms listed in Section 106(c)(1)], binds governmental units." In addition, as the district court stressed (Pet. App. A42), it is difficult to harmonize the bankruptcy court's broad interpretation of Section 106(c) with Sections 106(a) and (b). Section 106(a) authorizes compulsory counterclaims against governmental units *if*

the agency has filed a proof of claim in the bankruptcy proceeding, and Section 106(b) authorizes permissive counterclaims for offset purposes, "but, again, only *after* the sovereign files its own proof of claim" (Pet. App. A43 (emphasis in original)). "The express waiver of sovereign immunity in the carefully limited circumstances provided for in subsections (a) and (b) would seem to preclude reading subsection (c) as a completely independent wide-open waiver of sovereign immunity which would permit suits against the state for retroactive money damages irrespective of whether the state had first brought suit against the estate" (*id.* at A43-A44). Noting that "waivers of sovereign immunity must be strictly construed in favor of the sovereign" (*id.* at A45-A46), particularly where the Eleventh Amendment is at issue, the court concluded that the bankruptcy court lacked jurisdiction over petitioner's turnover claim (*id.* at A69).

In Zera's case, the district court relied on its decision in *Willington*. The court again agreed with that the United States (Pet. App. A94) that Section 106(c) authorizes preference actions against governmental units only where the bankruptcy court has in rem jurisdiction, such as when a trustee seeks to set aside a preferential lien of a sovereign on property within the estate. The court concluded, like the United States, that nothing in the Bankruptcy Code showed that Congress plainly intended "to abrogate the states' immunity to suit in bankruptcy court for recovery of funds from the state treasury" by means of an action to avoid a preference (*id.* at A95). The court acknowledged (*id.* at A92) that the Seventh Circuit had reached a contrary conclusion *In re McVey Trucking, Inc.*, 812 F.2d 311 (1987), cert. denied, No. 86-1847 (Oct. 13, 1987). As in *Willington*, the district court found it unnecessary to discuss whether Congress has the power under the Bankruptcy Clause to abrogate states' immunity.

4. The court of appeals, after consolidating the cases, affirmed the district court's conclusion that the bankruptcy court lacked jurisdiction over petitioner's claims (Pet. App. A1-A19). The court focused on the language of Section 106(c)(2), which "provides only that governmental units are *bound* by 'a *determination* by the court of *an issue* arising under' a provision containing one of the 'triggering' terms enumerated in subsection (c)(1)" (Pet. App. A12 (emphasis in original)). "[P]articularly when read in light of § 106(a) and (b)," the court said, it seems plain that Section 106(c) "waives state sovereign immunity only to the extent necessary for the bankruptcy court to determine a state's rights in the debtor's estate" (*id.* at A12-A13).

The court of appeals found support for its conclusion in the legislative history, which makes clear that the primary purpose of Section 106(c) was to codify the results in *In re Gwilliam*, 519 F.2d 407 (9th Cir. 1975), and *In re Dolard*, 519 F.2d 282 (9th Cir. 1975), where the courts held that bankruptcy courts may determine the amount and dischargeability of unpaid taxes. Both the Senate and House bills had preserved sovereign immunity for tax authorities. S. Rep. 95-1106, 95th Cong., 2d Sess. 6 (1978); H.R. Rep. 95-595, 95th Cong., 1st Sess. 317 (1977). Thus, if the holdings of *Gwilliam* and *Dolard* were to be preserved, it was necessary to add Section 106(c) to provide that bankruptcy courts could issue binding determinations with respect to tax liabilities. Members of the Conference Committee stated that this was in fact the primary purpose of Section 106(c). See 124 Cong. Rec. 32394 (1978) (statement of Rep. Edwards); *id.* at 33993 (statement of Sen. DeConcini). Nothing in the legislative history, the court of appeals stated, "indicate[d] that the scope of the sovereign immunity waiver was intended to extend beyond *determinations* of the bankruptcy court" and to allow original

actions against a State for money damages (Pet. App. A15 (emphasis in original)).

Moreover, since "statutes that purport to waive immunity construed are strictly construed in the sovereign's favor" (Pet. App. A17), and Congress must abrogate Eleventh Amendment immunity with particular clarity, the court held that governmental units are not subject "to adversarial proceedings in bankruptcy that involve payment of * * * funds to the estate," except as provided in Section 106(a) (Pet. App. A17). Like the district court, the court of appeals noted (*ibid.*) that the Seventh Circuit had reached a contrary conclusion in *McVey,* which, like Zera's case, involved a preference action, and that the Third Circuit had reached a contrary conclusion in *In re Vazquez,* 788 F.2d 130 (1986), cert. denied, No. 86-5467 (Nov. 3, 1986), which involved an action to recover a debt collected in violation of 11 U.S.C. 524(a), which is comparable to the turnover action petitioner seeks to bring on behalf of Willington.

ARGUMENT

Although the court of appeals correctly concluded that Section 106(c) does not provide jurisdiction for petitioner's suits, review by this Court is warranted because the courts of appeals are divided on the question presented, which involves a recurring issue of substantial importance to trustees in bankruptcy and to state and federal agencies.

1. As the lower courts acknowledged (Pet. App. A17, A92), the decision below is in direct conflict with the Seventh Circuit's decision in *McVey.* In addition, as the court of appeals noted (*id.* at A17), its decision is inconsistent with the Third Circuit's decision in *Vazquez,* where the court decided, after considering the issue only in passing, to give Section 106(c) a "broad interpretation" (788 F.2d at 133) encompassing authority to bring suit to recover a debt collected in violation of 11 U.S.C. 524(a).

In concluding that trustees may seek to obtain money from state agencies by means of preference actions, the Seventh Circuit in *McVey,* like the bankruptcy court below, ignored the language of Section 106(c)(2). As the court of appeals below concluded, that language is properly read as confining the scope of Section 106(c)'s waiver of sovereign immunity to actions where a bankruptcy court seeks to bind a government agency to a determination not requiring a payment of money from the agency to the bankrupt estate. That reading harmonizes Section 106(c) with Sections 106(a) and (b), and finds additional support in the legislative history explaining the Conference Committee's decision to add Section 106(c).

The Seventh Circuit rejected the argument that its broad reading of Section 106(c) rendered Sections 106(a) and (b) superfluous, explaining that Sections 106(a) and (b) "concern cases in which a state, by filing a proof of claim, consents to have claims adjudicated by the bankruptcy court," whereas by Section 106(c) Congress "create[d] a cause of action against an unconsenting state" (812 F.2d at 327 (footnote omitted)). That is no answer at all, since Section 106(c), as read by the Seventh Circuit, allows suits against states whether or not they file a proof of claim. To be sure, as court below acknowledged, petitioner's reading of Section 106(c) would not render Sections 106(a) and (b) completely redundant, since Section 106(c), unlike Sections 106(a) and (b), applies only to Code provisions containing the triggering terms listed in Section 106(c)(1) (Pet. App. A13 n.5). Nevertheless, petitioner's interpretation of Section 106(c) would encompass most claims that would be brought against a sovereign by a bankruptcy trustee; tort claims would be authorized by Section 106(a) and (b), but

not Section 106(c), but they are much less common in bankruptcy cases than contract claims. In practice, therefore, petitioner's broad reading, endorsed by the Seventh Circuit and the bankruptcy court below, would largely swallow most of the rule established by Sections 106(a) and (b), which is that governmental units are subject to suit for money damages only when they have filed a proof of claim. The narrow language of Section 106(c), along with its sparse legislative history, which primarily focused on the *Gwilliam* and *Dolard* decisions, is not compatible with an interpretation of Section 106(c) that renders governmental units subject to suits for money damages in any contract action, whether or not they file a proof of claim.

The Seventh Circuit also relied on a statement in the legislative history that Section 106(c) " 'permits a . . . debtor in possession to assert avoiding powers under Title 11 against a government unit.' " 812 F.2d at 327 (quoting 124 Cong. Rec. 32394 (1978) (statement of Rep. Edwards); *id.* at 33993 (statement of Sen. DeConcini)). That statement, however, is properly read as recognizing that Section 106(c) authorizes preference actions against governmental units in cases where the bankruptcy court has in rem jurisdiction, such as where the trustee seeks to set aside a preferential lien on property held by the estate. It should not be taken as suggesting that any preference action, including the action whereby petitioner sought to recover $2,100.62 from the State on behalf of Zera's estate, is authorized.

2. The question of the proper interpretation of Section 106(c) is important to bankruptcy trustees and to state and federal agencies. Cases involving suits like those brought by petitioner, where trustees seek to recover money from state agencies, arise frequently and, in addition to the conflict in the circuits, the district courts and bankruptcy

courts have reached various conclusions as to the reach of Section 106(c). Compare *In re Lawson Burich Ass'n*, 59 Bankr. 681 (Bankr. S.D.N.Y. 1986); *In re Crum*, 20 Bankr. 160 (Bankr. D. Idaho 1982); *In re Regal Construction Co., Inc.*, 18 Bankr. 353 (Bankr. D. Md. 1982); *In re Ramos*, 12 Bankr. 250 (Bankr. N.D. Ill. 1981); and *In re Community Hospital of Rockland County*, 5 Bankr. 11 (S.D.N.Y. 1980); with *In re Maytag Sales & Serv., Inc.*, 23 Bankr. 384 (Bankr. W.D. Ga. 1981); *In re Community Hospital of Rockland County*, 15 Bankr. 785 (Bankr. S.D.N.Y. 1981); and *In re Remke, Inc.*, 5 Bankr. 299 (Bankr. E.D. Mich. 1980). While this case involves an action against a state agency, the same result will presumably obtain in cases where trustees seek money from federal agencies, since Section 106(c) applies to "governmental units," which are defined to include federal as well as state agencies (11 U.S.C. 101(26)). The question presented is therefore of considerable interest to the federal government.

Although the court below noted the especially heavy presumption against waivers of Eleventh Amendment immunity (Pet. App. A16-A18), and the respondent in *Pennsylvania* v. *Union Gas Co.*, No. 87-1241 (argued Oct. 31, 1988), has asked this Court to reconsider its Eleventh Amendment jurisprudence, we see no good reason to hold this case pending a decision in that case. The threshold question of statutory construction, as to which the courts of appeals have divided, must be resolved before any question of Eleventh Amendment immunity is considered. If the Court concludes, as we urge, that the construction adopted by the court below is correct, then the Eleventh Amendment issues need not be reached. On the other hand, if the Court agrees with petitioner's reading of the statute, then the Court can either dispose of the Eleventh Amendment issue in light of the principles established in

Pennsylvania v. *Union Gas,* or can remand to the court of appeals for application of those principles, as it sees fit.

In our view, moreover, the statutory construction issue can be resolved on the basis of the text and legislative history of Section 106(c), without the need to resort to any presumptions governing statutory construction derived from the Eleventh Amendment. No matter how the Court disposes of the issue presented in *Pennsylvania* v. *Union Gas*, the general presumption in favor of reading waivers of sovereign immunity narrowly, which was cited by both the court of appeals (Pet. App. A17) and the district court (*id.* at A45-A46), will remain and weigh against adoption of petitioner's interpretation of Section 106(c).

Finally, we do not think that the arguments advanced in Connecticut's brief in opposition make review inappropriate. Connecticut argues primarily (Pet. 5) that this is a poor case to resolve the question whether Congress has the power to abrogate Eleventh Amendment immunity under the Bankruptcy Clause, since the court of appeals and the district court below did not address the issue. The question that we think warrants review, however, is whether the court of appeals properly construed Section 106(c). If the court's decision is correct, then it is not necessary to reach any Eleventh Amendment question at all, including the question whether Congress has the power to abrogate the Eleventh Amendment under the Bankruptcy Clause. In any event, that question was analyzed in detail in *McVey* (812 F.2d at 314-323), and was addressed by the many courts cited in the bankruptcy court's discussion of the issue (Pet. App. A129-A136).

Connecticut also notes that, in the Willington case, the district court found "that the terms of Willington's contract with Connecticut entitled the state to recoup past overpayments to Willington by withholding the funds due for services provided in March 1983" (Pet. App. A71).

Connecticut argues that this is an independent ground supporting the district court's decision (Pet. 7). Even if this were such an independent ground, it would have no application to Zera's case, on which there is a precise conflict with the Seventh Circuit's decision as to whether trustees may seek to set aside a preferential transfer and recover money from a governmental unit. Moreover, the court of appeals in fact did not rely on the district court's finding, so it cannot be regarded as an alternative basis for its decision even with respect to Willington's case. In addition, the district court's short statement does not appear to be an alternative holding, but merely a finding of fact that would have aided the court of appeals, had it construed Section 106(c) differently than the district court, in determining whether, as a matter of law, there was merit to petitioner's turnover action.

CONCLUSION

The petition for writ of certiorari should be granted.

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In The
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OCTOBER TERM, 1988

MARTIN W. HOFFMAN, TRUSTEE
Petitioner

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CONNECTICUT DEPARTMENT OF INCOME MAINTENANCE, ET AL.
Respondents

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

JOINT APPENDIX

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PETITION FOR CERTIORARI FILED SEPTEMBER 7, 1988
CERTIORARI GRANTED JANUARY 9, 1989

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Willington Convalescent Home, Inc.

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2-03-84	Defendant's Motion to Dismiss.
3-07-84	Plaintiff's Memorandum in Support of the Motion in Opposition to Defendant's Motion to Dismiss.
3-07-84	Motion in Opposition to Defendants' Motion to Dismiss.
4-25-84	Memorandum & Order *Denying* Defendant's Motion to Dismiss: Attys. Martin Hoffman, Kenneth Graham & Arnold Menchel (State of Ct.), Stanley Peck (State of Ct).
5-16-84	Order Granting Motion for Stay of Memorandum & Order dated 4/25/84 CC: Attys. Martin Hoffman, Stanley Peck, Ken Graham & Arnold Menchel, per
5-25-84	Notice of Appeal by St. of Ct., Dept. of Income Maintenance, Dept. of Health Services, Def. on Denial of Motion to Dismiss.
6-05-84	Copy of Record on Appeal received from Bankruptcy Office. Appeal is on Denial of Motion to dismiss. Notice mailed to counsel.
6-20-84	Brief of the Appellants filed.
7-10-84	Brief of the Appellee M. Hoffman filed.

7-27-84 Reply Brief of Appellants filed.

6-18-85 Certification Order Pursuant to 28 U.S.C. Sec. 2403(b) Atty. General to report re: intervention on or by 7-19-85 Dorsey, J. — cc mld (LW).

9-20-85 Motion for Intervention of the United States with attached Brief in support fld (LW).

9-27-85 Intervening Brief of the United States fld (LW).

10-18-85 END on dckt #16 "GRANTED", Dorsey, J. — cc mld (CB).

5-11-87 Memorandum of Decision (The ruling of Bankruptcy Court is reversed and appellants' Mot. to Dismiss is GRANTED.) Dorsey, J. — cc mld (LW) M. 5/12/87.

5-12-87 Judgment fld and entered deft. Rowe, C. — cc mld (LW) M/5/15/87.

6-04-87 Notice of Appeal from final judgment. Fee paid. Civil Management Plan and Forms C & D handed to appellant's counsel. Certified copy of notice and docket sheet mld to USCA; copies to counsel (CB).

6-08-87 Copy of district court docket entries and notice of appeal on behalf of the appellant Martin W. Hoffman, Trustee, filed.

10-09-87 Appellant Martin Hoffman, Trustee — brief filed (W/pfs).

10-09-87 Appellant Martin Hoffman, Trustee — appendix filed (w/pfs).

11-09-87 Appellee Connecticut Dept. of Income Maintenance filed briefs w/pfs.

11-13-87 Intervenor-Appellee USA — brief filed (w/pfs) (OK per MJ).

11-20-87 Order granted Appellee Connecticut Dept. of Income Maintenance motion for to filed supplemental appendix filed (EBG).

11-23-87 Appellant Martin W. Hoffman, Trustee reply brief filed w/pfs.

1-27-88 Case heard before Oakes, Newman, Miner, C.JJ.

6-15-88 Judgment Affirmed by published signed opinion per Judge Miner (& in 87-5023) Judgment Filed.

Chapter 7 Proceeding No. 2-82-00508
Adversary Proceeding No. 2-84-0007

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

WILLINGTON CONVALESCENT HOME, INC.
Debtor

MARTIN W. HOFFMAN, TRUSTEE
Plaintiff

v.

STATE OF CONNECTICUT,
DEPARTMENT OF INCOME MAINTENANCE
DEPARTMENT OF HEALTH SERVICES,
Defendants

COMPLAINT

(dated December 30, 1983)

---

1. Willington Convalescent Home, Inc. filed a Chapter 11 Proceeding on June 2, 1982. Said matter was converted to a Chapter 7 Proceeding on July 27, 1983, and Martin W. Hoffman, Esq., was appointed as Trustee of said estate on that date.

2. This adversary proceeding is brought pursuant to Rule 701 of the Rules of Bankruptcy Procedure to recover a money judgment against the Defendants for services sold and delivered on account. Jurisdiction is conferred on this Court by 28 U.S.C. Section 1471.

3. The Defendant, Department of Health Services, has an address of 110 Bartholomew Avenue, Hartford, Connecticut 06115.

4. The Defendant, Department of Health Services, has an address of 79 Elm Street, Hartford, Connecticut.

5. Prior to the commencement of this action, the Debtor performed services on account to the Defendants in the amount of $64,010.24.

6. Said amount has been due and owing to the Debtor for more than ninety (90) days.

7. Notwithstanding demand, the Defendants have failed to pay the amount due on said account.

WHEREFORE, Plaintiff prays that this Court:

1. Enter a judgment of money damages against the Defendants for the amount due on said account, together with interest thereon.

2. Grant the Debtor such other and further relief as the Court may deem just and proper, including costs of this action.

Dated at Hartford, Connecticut, this 30th day of December, 1983.

PLAINTIFF:
Martin W. Hoffman, Trustee

By /s/ Martin W. Hoffman

Martin W. Hoffman
Attorney for the Trustee
410 Asylum Street
Hartford, CT 06103

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

(Caption omitted in printing)

MOTION TO DISMISS

(February 3, 1984)

Pursuant to the Federal Rules of Civil Procedure, Rule 12(b) (1) and (6) and Bankr. Rule 7012, 11 U.S.C.A. (effective August 1, 1983), the defendants respectfully move the Court to dismiss the above-entitled Adversary Proceeding due to a lack of jurisdiction over the subject matter and failure to state a claim upon which relief can be granted for the following reasons:

1. The sole business relationship between the debtor and the defendant state agencies was the debtor's former status as a "nursing home" provider participant in the Connecticut Medicaid Program until March of 1983 (See attached Affidavit in Support of Motion to Dismiss).

2. As a nursing home provider participant in the Connecticut Medicaid Program, the debtor submitted annual reports for cost years ending September thirtieth of each year which constituted the basis for computation of annual per diem Medicaid rates to commence July first of the following year. While the Department of Income Maintenance took the word of debtor as to the representations made in said annual reports, said resulting Medicaid rates were subject to subsequent field audit and retroactive rate recomputation if unallowable costs were discovered. See Regulations of Connecticut State Agencies § 17-311-50 *et seq.* ("Medicaid Cost Related Reimbursement System") and the attached Affidavit in Support of Motion to Dismiss).

3. A field audit report dated December 3, 1980 determined that debtor had included unallowable costs in its annual

reports and had therefore received Medicaid overpayments. The Department of Income Maintenance issued two (2) Medicaid rate decisions for different rate years implementing the recommended retroactive revised Medicaid rate recomputations which resulted in both prepetition and postpetition recoupment from monthly Medicaid payment checks to debtor in partial satisfaction of debtor's indebtedness to the State for most Medicaid overpayments. Said recoupment ceased when the debtor ceased operations in early 1983 (See attached Affidavit).

4. The provider agreements between the debtor and the Department of Income Maintenance were in the nature of an executory contract which gave the Medicaid Program the right to recoup past Medicaid overpayments from the debtor's monthly Medicaid checks because a debtor may not accept an executory contract's benefits while evading its burdens. The trustee's complaint is therefore barred.

5. The Eleventh Amendment to the Constitution of the United States operates as a bar to the trustee's complaint because the entirety of said complaint seeks retroactive pecuniary relief from a federal court against a state government where the state has not waived its Eleventh Amendment immunity.

6. The Sovereign Immunity enjoyed by the State of Connecticut operates as a bar to the trustee's complaint as the defendant state agencies have filed no claim against debtor's estate, no objection to discharge, no request for affirmative relief from the Bankruptcy Court and are not the plaintiffs in any other forum pursuing a claim against debtor's estate.

7. With respect to aforesaid second Medicaid rate decision, concerning which debtor made a timely administrative Medicaid rate hearing request but then requested that said hearing be postponed indefinitely, the debtor's failure to exhaust its available administrative remedy operates as a bar to the trustee's complaint. In the alternative, the doctrine of

primary jurisdiction operates as a bar to the trustee's complaint.

8. With respect to the aforesaid first Medicaid rate decision concerning which the debtor failed to make a timely administrative Medicaid rate hearing request, said decision is final and correct as a matter of law and entitled to res judicata effect and statutory full faith and credit as per 28 U.S.C. § 1738, thereby operating as a bar to the trustee's complaint.

WHEREFORE, THE DEFENDANTS PRAY DISMISSAL OF THE TRUSTEE'S COMPLAINT.

DEFENDANT, CONNECTICUT DEPARTMENT OF INCOME MAINTENANCE,

BY ITS ATTORNEY
JOSEPH I. LIEBERMAN
ATTORNEY GENERAL

By: /s/ Kenneth A. Graham

Kenneth A. Graham
Assistant Attorney General
90 Brainard Road
Hartford, CT 06114
Telephone: 566-7098

By: /s/ Arnold I. Menchel

Arnold I. Menchel
Assistant Attorney General
90 Brainard Road
Hartford, CT 06114
Telephone: 566-7098

DEFENDANT, CONNECTICUT DEPARTMENT OF HEALTH SERVICES

BY ITS ATORNEY
JOSEPH I. LIEBERMAN
ATTORNEY GENERAL

By: /s/ Stanley K. Peck

Stanley K. Peck
Assistant Attorney General
30 Trinity Street
Hartford, CT 06106
Telephone: 566-4990

ORDER

The foregoing Motion to Dismiss, having been duly heard by the Court, it is hereby GRANTED/DENIED

U.S. Bankruptcy Judge

(Certificate of Service omitted in printing)

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

(Caption omitted in printing)

MOTION IN OPPOSITION TO DEFENDANTS' MOTION TO DISMISS

(March 6, 1984)

The Plaintiff, Martin W. Hoffman, Trustee, respectfully requests that the Defendants' Motion to Dismiss be denied as this Court has jurisdiction over the subject matter. Additionally, Defendants' Motion to Dismiss should be denied as the Plaintiff has stated a claim upon which relief can be granted.

PLAINTIFF:
Martin W. Hoffman, Trustee

By /s/ Martin W. Hoffman

Martin W. Hoffman
Attorney for the Trustee
410 Asylum Street
Hartford, CT 06103
Tel. (203) 525-4287

(Certificate of Service omitted in printing)

ORDER

DATED AT HARTFORD, CONNECTICUT, THIS _____ DAY OF _____, 1984.

Upon the foregoing Motion in Opposition to Defendants' Motion to Dismiss, having been duly heard by the Court, it is hereby

ORDERED: Granted/denied.

_____
ROBERT L. KRECHEVSKY
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

In The Matter Of:	Case No. 2-83-00508
WILLINGTON CONVALESCENT HOME, INC. Debtor	)
MARTIN W. HOFFMAN, TRUSTEE Plaintiff	)
V.	) Adversary Proceeding
STATE OF CONNECTICUT, DEPARTMENT OF INCOME MAINTENANCE, DEPT. OF HEALTH SERVICES, Defendant	) No. 2-84-0007

CONSENT TO ENTRY OF JUDGMENT OR DISPOSITIVE ORDER BY A UNITED STATES BANKRUPTCY JUDGE

In accordance with the provisions of the Emergency Resolution for Administration of Bankruptcy System adopted by the United States District Judges for the District of Connecticut on December 22, 1982, the parties to the above-captioned related proceeding hereby waive their right to have the Bankruptcy Judge submit findings, conclusions, and a proposed judgment or order to a District Judge and consent to have a Bankruptcy Judge hear the proceeding and enter a final judgment or dispositive order. The parties expressly reserve all rights to appeal the merits of such final judgment or dispositive order.

/s/ Martin W. Hoffman	April 5, 1984
Martin W. Hoffman, Attorney for the Trustee	DATE
/s/ Kenneth A. Graham	April 10, 1984
Kenneth A. Graham, Assistant Attorney General	DATE
/s/ Arnold I. Menchel	April 10, 1984
Arnold I. Menchel, Assistant Attorney General	DATE
/s/ Stanley K. Peck	April 10, 1984
Stanley K. Peck, Assistant Attorney General	DATE

UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

EMERGENCY RESOLUTION FOR ADMINISTRATION OF BANKRUPTCY SYSTEM

We, the United States District Judges for the District of Connecticut, hereby unanimously adopt the following Emergency Resolution for the Administration of the Bankruptcy System in the District of Connecticut, acting pursuant to an Order of the Judicial Council of the Second Circuit:

"BE IT ENACTED:

(a) Emergency Resolution

The purpose of this rule is to supplement existing law and rules in respect to the authority of the Bankruptcy Judges of this District to act in bankruptcy cases and proceedings until Congress enacts appropriate remedial legislation in response to the Supreme Court's decision in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, ____ U.S. ____, 102 S.Ct. 2858 (1982), or until March 31, 1984, whichever first occurs.

The Judges of the District Court find that exceptional circumstances exist. These circumstances include: . . . (1) the unanticipated unconstitutionality of the grant of power to Bankruptcy Judges in § 241(a) of Public Law 95-598; (2) the clear intent of Congress to refer bankruptcy matters to Bankruptcy Judges; (3) the specialized expertise necessary to the determination of bankruptcy matters; and (4) the administrative difficulty of the District Courts' assuming the existing bankruptcy caseload on short notice.

Therefore, the orderly conduct of the business of the Court requires this referral of bankruptcy cases to the Bankruptcy Judges.

(b) Filing of Bankruptcy Papers

The Bankruptcy Court constituted by § 404 of Public Law 95-598 shall continue to be known as the United States Bankruptcy Court of this District. The Clerk of the Bankruptcy Court is hereby designated to maintain all files in bankruptcy cases and adversary proceedings. All papers in cases or proceedings arising under or related to Title 11 shall be filed with the Clerk of the Bankruptcy Court regardless of whether the case or proceeding is before a Bankruptcy Judge or a Judge of the District Court, except that a judgment by the District Judge shall be filed in accordance with Rule 921 of the Bankruptcy Rules.

(c) Reference to Bankruptcy Judges

(1) All cases under Title 11 and all civil proceedings arising under Title 11 or arising in or related to cases under Title 11 are referred to the Bankruptcy Judges of this District.

(2) The reference to a Bankruptcy Judge may be withdrawn by the District Court at any time on its own motion or on timely motion by a party. A motion for withdrawal of reference shall not stay any bankruptcy matter pending before a Bankruptcy Judge unless a specific stay is issued by the District Court. If a reference is withdrawn, the District Court may retain the entire matter, may refer part of the matter back to the Bankruptcy Judge, or may refer the entire matter back to the Bankruptcy Judge with instructions specifying the powers and functions that the Bankruptcy Judge may exercise. Any matter in which the reference is withdrawn shall be reassigned to a District Judge in accordance with the Court's usual system for assigning civil cases.

(3) Referred cases and proceedings may be transferred in whole or in part between Bankruptcy Judges within the District without approval of a District Judge.

(d) Powers of Bankruptcy Judges

(1) The Bankruptcy Judges may perform in referred bankruptcy cases and proceedings all acts and duties necessary for

the handling of those cases and proceedings except that the Bankruptcy Judges may not conduct:

(A) a proceeding to enjoin a court;

(B) a proceeding to punish a criminal contempt —

(i) not committed in the Bankruptcy Judge's actual presence; or

(ii) warranting a punishment of imprisonment;

(C) an appeal from a judgment, order, decree, or decision of a United States Bankruptcy Judge; or

(D) jury trials.

Those matters which may not be performed by a Bankruptcy Judge shall be transferred to a District Judge.

(2) Except as provided in (d)(3), orders and judgments of Bankruptcy Judges shall be effective upon entry by the Clerk of the Bankruptcy Court, unless stayed by the Bankruptcy Judge or a District Judge.

(3) (A) Related proceedings are those civil proceedings that, in the absence of a petition in bankruptcy, could have been brought in a District court or a State Court. Related proceedings include, but are not limited to, claims brought by the estate against parties who have not filed claims against the estate. Related proceedings do not include: contested and uncontested matters concerning the administration of the estate; allowance of and objection to claims against the estate; counterclaims by the estate in whatever amount against persons filing claims against the estate; orders in respect to obtaining credit; orders to turn over property of the estate; proceedings to set aside preferences and fraudulent conveyances; proceedings in respect to lifting of the automatic stay; proceedings to determine dischargeability of particular debts;

proceedings to object to the discharge; proceedings in respect to the confirmation of plans; orders approving the sale of property where not arising from proceedings resulting from claims brought by the estate against parties who have not filed claims against the estate; and similar matters. A proceeding is not a related proceeding merely because the outcome will be affected by state law.

(B) In related proceedings the Bankruptcy Judge may not enter a judgment or dispositive order, but shall submit findings, conclusions, and a proposed judgment or order to the District Judge, unless the parties to the proceeding consent to entry of the judgment or order by the Bankruptcy Judge.

(e) District Court Review

(1) A notice of appeal from a final order or judgment or proposed order or judgment of a Bankruptcy Judge or an application for leave to appeal an interlocutory order of a Bankruptcy Judge, shall be filed within ten (10) days of the date of entry of the judgment or order or of the lodgment of the proposed judgment or order. As modified by §§ (e) 2A and B of this rule, the procedures set forth in Part VIII of the Bankruptcy Rules apply to appeals of Bankruptcy Judges' judgments and orders and the procedures set forth in Bankruptcy Interim Rule 8004 apply to applications for leave to appeal interlocutory orders of Bankruptcy Judges. Modification by the District Judge or the Bankruptcy Judge of time for appeal is governed by Rule 802 of the Bankruptcy Rules.

(2) (A) A District Judge shall review:

(i) an order or judgment entered under paragraph (d)(2) if a timely notice of appeal has been filed or if a timely application for leave to appeal has been granted;

(ii) an order or judgment entered under paragraph (d)(2) if the Bankruptcy Judge certifies that circumstances require that the order

or judgment be approved by a District Judge, whether or not the matter was controverted before the Bankruptcy Judge or any notice of appeal or application for leave to appeal was filed; and

(iii) a proposed order or judgment lodged under paragraph (d)(3), whether or not any notice of appeal or application for leave to appeal has been filed.

(B) In conducting review, the District Judge may hold a hearing and may receive such evidence as appropriate and may accept, reject, or modify, in whole or in part, the order or judgment of the Bankruptcy Judge, and need give no deference to the findings of the Bankruptcy Judge. At the conclusion of the review, the District Judge shall enter an appropriate order or judgment.

(3) When the Bankruptcy Judge certifies that circumstances require immediate review by a District Judge of any matter subject to review under paragraph (d)(2), the District Judge shall review the matter and enter an order or judgment as soon as possible.

(4) It shall be the burden of the parties to raise the issue of whether any proceeding is a related proceeding prior to the time of the entry of the order of judgment of the District Judge after review.

(f) Local Rules

In proceedings before a Bankruptcy Judge, the local rules of the Bankruptcy Court shall apply. In proceedings before a Judge of the District Court, the local rules of the District Court shall apply.

(g) Bankruptcy Rules and Title IV of Public Law 95-598

Courts of bankruptcy and procedure in bankruptcy shall continue to be governed by Title IV of Public Law 95-598 as amended and by the bankruptcy rules prescribed by the Supreme Court of the United States pursuant to 28 U.S.C. § 2075 and limited by § 405(d) of the Act, to the extent that

such Title and Rules are not inconsistent with the holding of *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, ____ U.S. ____, 102 S.Ct. 2858 (1982).

(h) Effective Date and Pending Cases

This rule shall become effective December 25, 1982, and shall apply to all bankruptcy cases and proceedings not governed by the Bankruptcy Act of 1898 as amended, and filed on or after October 1, 1979. Any bankruptcy matters pending before a Bankruptcy Judge on December 25, 1982 shall be deemed referred to that Judge."

Dated at Bridgeport, Connecticut, this 22nd day of December, 1982.

/s/ T. Emmet Clarie

T. Emmet Clarie
Chief United States District Judge

/s/ T.F. Gilroy Daly

T.F. Gilroy Daly
United States District Judge

/s/ Ellen B. Burns

Ellen Bree Burns
United States District Judge

/s/ Warren W. Eginton

Warren W. Eginton
United States District Judge

/s/ José A. Cabranes

José A. Cabranes
United States District Judge

Civil H 84-636 PCD

UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

WILLINGTON CONVALESCENT HOME, INC.

STATE OF CONNECTICUT,
DEPARTMENT OF INCOME MAINTENANCE
DEPARTMENT OF HEALTH SERVICES,

v.

MARTIN W. HOFFMAN, TRUSTEE

JUDGMENT

This action having come on for consideration of the appellant State of Connecticut's motion to appeal decision of bankruptcy court before the Honorable Peter C. Dorsey, United States District Judge, and

The Court having considered the full record of the case including applicable principles of law, and the Court having filed its Memorandum of Decision, reversing the decision of the bankruptcy and granting the motion to dismiss,

It is accordingly ORDERED, ADJUDGED and DECREED that judgment be and is hereby entered.

Dated at Hartford, Connecticut, this 12th day of May 1987.

KEVIN F. ROWE, Clerk

By /s/ Dennis P. Iavarone

Dennis P. Iavarone
Deputy-in-Charge

(Pages 47-57 of Connecticut's Brief dated June 20, 1984)

ARGUMENT III

THE STATE MEDICAID AGENCY'S RIGHT TO RECOUP PAST MEDICAID OVERPAYMENTS FROM THE MONTHLY MEDICAID PAYMENT CHECKS SENT TO A NURSING HOME DEBTOR

A. FACTUAL INTRODUCTION

From the perspective of Appellant Connecticut Department of Income Maintenance, Judge Krechevsky's decision on this issue constitutes the greatest fiscal threat to the fiscal integrity of the Connecticut Medicaid Program of the five (5) separate and distinct grounds of the denied Motion to Dismiss.*

As described in the Statement of the Case, *supra*, the State takes the word of the nursing home as to the costs claimed in the facility's unaudited annual cost report and computes the facility's annual Medicaid rate in reliance. Of course, pursuant to the provider agreement between the State Medicaid agency and the nursing home in the Medicaid Program, *subsequent* field audits occur generally on a biennial basis and if unallowable costs are discovered, the Medicaid rates are recomputed and recoupment of the past Medicaid overpayments occurs from the monthly Medicaid payment checks sent by the State to the nursing home.

Obviously, the consideration of the contract for the nursing home are the Medicaid rates which determine the amount paid to the facility.

Equally obviously, the consideration for the State Medicaid agency is that Medicaid tax dollars paid to a nursing home are in fact spent on the care of Title XIX Medicaid

* The budget of the Connecticut Department of Income Maintenance is approximately 25% of the entire annual State budget, and the nursing home Medicaid payments constitute the largest single component of said agency budget.

patients and not illegally diverted elsewhere. Therefore, the subsequent field audit/rate recomputation/recoupment part of the provider agreement is the heart of the State's consideration, i.e., the essence of the contract.

As will soon be demonstrated, until Judge Krechevsky's decision five (5) of the six (6) bankruptcy cases on this point came down in favor of the right of the Medicare/Medicaid government agency to recoup such past overpayments from current payment checks to nursing homes even after they filed in bankruptcy on the theory that a nursing home could not accept the benefits of its executory contract (continued participation in Medicare/Medicaid and continued payment checks from the government) while evading the burdens of the same contract (field auditing and recoupment of past overpayments).

So long as this line of bankruptcy case law remains the law, a deterrent exists against nursing home owners filling their annual cost reports with false claims and pocketing illegal Medicaid overpayments for a few years until the field auditors catch them, *to wit*, they know that whether or not they file in bankruptcy, the past overpayments will be recouped.

Judge Krechevsky totally misunderstood the Appellants' argument to be that any monies the Trustee recovers post petition would go into the pockets of the nursing home owner. Of course not. But that was not the State's argument. Rather, the above described deterrent discourages prepetition filing of false or questionable cost claims and prepetition personal pocketing of overpayments by the average nursing home owner who realizes that filing in Chapter 11 will not prevent the requisite recoupment. (Again, see the Statement of the Case as to why nursing homes already have an incentive to file in bankruptcy even without elimination of said deterrent.)

B. THE PROVIDER AGREEMENTS BETWEEN THE DEBTOR AND THE DEPARTMENT OF INCOME MAINTENANCE CONSTITUTED AN EXECUTORY CONTRACT WHICH GAVE THE STATE MEDICAID AGENCY THE RIGHT TO RECOUP PAST MEDICAID OVERPAYMENTS FROM THE DEBTOR NURSING HOME'S MONTHLY MEDICAID CHECKS BECAUSE A DEBTOR MAY NOT ACCEPT AN EXECUTORY CONTRACT'S BENEFITS WHILE EVADING ITS BURDENS.

The landmark bankruptcy case on this issue is *In Re Monsour Medical Center*, 8 B.R. 606 (Bankr. W.D. Penn. 1981), aff'd. 11 B.R. 1014 (W.D. Penn. 1981).

The *Monsour* bankruptcy court held that three (3) different annual provider agreements between Medicare and the provider *constituted one (1) executory contract* (8 B.R. at 613), and that on the date the debtor filed in bankruptcy, the government continued to have the contractual right to make rate adjustments to minimize overpayment with the debtor having the ongoing contractual right to invoke the contract's dispute procedures (8 B.R. at 614) as if bankruptcy had not intervened (8 B.R. at 615).

On appeal, the *Monsour* district court rejected the facility's argument that its different one year provider agreements constituted separate and distinct contracts as opposed to one executory contract (11 B.R. at 1017) and then found that rate adjustments by the government were part of the executory contract and "do not violate the provisions of the Bankruptcy Code staying collection of antecedent debts." 11 B.R. at 1018.

In the bankruptcy case *In Re Berger*, 16 B.R. 236 (Bankr. S.D. Fla. 1981), a Medicare provider moved for a contempt citation against the government for recouping past Medicare overpayments from Medicare payments made to the debtor *after* filing in bankruptcy. The *Berger* bankruptcy court held: "I agree with the [*Monsour*] District Court's conclusion that

the adjustments of current payments in accordance with . . . the contractual agreement . . . do not violate the provisions of § 362." 16 B.R. at 237.

In *In Re Yonkers Hamilton Sanitarium, Inc.*, 22 B.R. 427 (Bankr. S.D.N.Y. 1982), the bankruptcy trustee for a Medicare provider argued that *Monsour* and *Berger* were incorrectly decided as viewing the relationship between the parties as if no bankruptcy had been filed, and in the alternative, the recoupment could not be affected because the provider agreement had neither been assumed nor rejected. 22 B.R. at 434.

Bankruptcy Judge Schwartzberg rejected the trustee's arguments holding:

> "It does not follow, however, that if neither party to an executory contract . . . takes any action with respect to assumption or rejection, the contract has no significance. *As long as the debtor continues to receive benefits under such contract it must also bear the burdens or obligations imposed under the contract.* [citation omitted] The *Monsour* and *Berger* cases are consistent with this principle *and were not incorrectly decided*, as the trustee's counsel contends." 22 B.R. at 435 (emphasis added)

The one and only case adverse to Medicare/Medicaid government agencies on this issue is *In Re Dartmouth House Nursing Home, Inc., et al*, 24 B.R. 256 (Bankr. D. Mass. 1982), which was premised on a major factual error, *to wit*, the assumption that each twelve month provider agreement is a separate executory contract (contra *Monsour*) and that the sole remaining obligation of the Medicaid agency after expiration of a twelve month provider agreement "is to correlate . . . rates, which is simply a ministerial and mathematical determination, which does not rise to the level of an executory obligation." 24 B.R. at 260 (i.e. the *Dartmouth* court's major factual error was its failure to recognize that the essence of the consideration for a state Medicaid agency is that

payments made in fact were used for patient care and not misappropriated).

Besides Judge Krechevsky, the only bankruptcy court to review *Dartmouth* rejected its reasoning as unpersuasive. *In Re Ambulance Corporation of America*, 27 B.R. 910, 912 (Bankr. E.D. Penn. 1983).*

The rational given by Judge Krechevsky for not following *Monsour, Berger* and *Yonkers* is twofold.

First, he cites the recent non-Medicare/Medicaid U.S. Supreme Court bankruptcy case of *N.L.R.B. v. Bildisco and Bildisco*, U.S. , 104 S. Ct. 1188, 79 L. Ed. 2d 482, 52 U.S.L.W. 4270 (1984) as, in effect, reversing *Yonkers* and rendering the provider agreement/executory contract unforceable because in *Willington* the provider agreement had neither been rejected nor assured.

However, in *Bildisco*, the debtor filed in Chapter 11 on April 14, 1980; refused to pay wage increases called for in the collective bargaining agreement in May, 1980 (giving actual notice by its conduct of unwillingness or inability to assume the executory contract); moved the Bankruptcy Court for permission to reject the collective bargaining agreement in December, 1980; and received such permission from the Bankruptcy Court on January 15, 1981. *Bildisco, supra* at 4271-4272.

In contrast, in *Willington*, the debtor filed in Chapter 11 on June 2, 1982; continued to participate as a nursing home provider in the Connecticut Medicaid Program and to receive monthly payment checks from the State until the facility

* Please note that while the *Ambulance* Court referred to the *Dartmouth* decision as *Massachusetts v. Erlin Manor Nursing Home*, this is in fact the *Dartmouth* decision found at 24 B.R. 256 (Erlin was the second named nursing home in that case, while Dartmouth was the first party in the same case).

closed in the Spring of 1983; *and never requested permission of the Bankruptcy Court to reject its provider agreement* during the entirety of its Chapter 11 proceeding (the case was converted to Chapter 7 on July 27, 1983).

While the *Bildisco* court noted that a Chapter 11 debtor has "more latitude *in deciding* whether to reject a contract . . ., *Bildisco, supra* at 4275 (emphasis added), in *Willington* the nursing home debtor *never decided* to reject and by its day-to-day conduct indicated just the opposite. In view of the factual differences between *Willington* and *Bildisco*, Appellants believe that *Yonkers* and not *Bildisco* is the appropriate case law authority.

Also, the very language Judge Krechevsky quoted from *Bildisco* states in part: "If the debtor-in-possession elects to continue to receive benefits from the other party to an executory contract pending a decision to reject or assume the contract, the debtor-in-possession is obligated to pay for the reasonable value of those services, *which, depending on the circumstances of a particular contract, may be what is specified in the contract . . .*" Memorandum and Order at p. 21 *quoting Bildisco, supra* at 4275.

Appellants contend that a Medicaid provider agreement is a classic example where "reasonable value" has to include the subsequent field auditing and recoupment provisions of the contract because, absent that, there is no mechanism to determine what in fact was spent on patient care. Again, the essence of the consideration for the State Medicaid agency is that Medicaid payments made to the nursing home were in fact used for the care of Title XIX Medicaid patients.

The second basis given by Judge Krechevsky for his decision in this issue is that, even if the provider agreement terms were enforceable without formal assumption, Connecticut's right to recover past Medicaid overpayments out of amounts due for March, 1983 services is a setoff and not recoupment right because defendant's right of recovery and plaintiff's

right of payment do not relate to the same subject matter. (Memorandum and Order at p. 22-23)

Appellants contend that this second basis is contrary to settled bankruptcy law not even arguably affected by *Bildisco*. For recoupment of past Medicare/Medicaid overpayments from current payments to providers is "merely an arrival at a just and proper liability on the main issue" arising out of the same transaction (i.e., the nursing home provider — Medicare/Medicaid agency ongoing relationship) *4 Collier on Bankruptcy*, ¶ 553.03, at 553.12 (15th Ed. 1981) *as quoted in Yonkers, supra* at 432, 433, and therefore is a right of recoupment and not a setoff. *Yonkers, supra.*

Judge Krechevsky then concludes that concerning the aforesaid right to recover versus right of payment, "neither relate to the same subject matter [contra *Yonkers*] nor arise from the same contract [contra *Monsour*, 8 B.R. at 613 *aff'd* 11 B.R. at 1017]"

Appellants respectfully submit that Judge Krechevsky erred in his holding on this issue and respectfully suggest that the reason for the error was his attempt to force non-Medicare/Medicaid bankruptcy cases into a *sui generis* area of Medicare/Medicaid bankruptcy law.

C. EVEN ASSUMING *ARGUENDO* JUDGE KRECHEVSKY'S VIEWS THAT A STATE MEDICAID AGENCY'S RECOUPMENT RIGHT IS ONLY A SETOFF RIGHT AND HIS READING OF *BILDISCO*, THE BANKRUPTCY COURT STILL ERRED IN HOLDING SUCH "SETOFFS" CONTRARY TO BANKRUPTCY LAW.

Even assuming *arguendo* that Judge Krechevsky was correct in viewing a State Medicaid agency's recoupment right as a setoff and was correct in his reading of *Bildisco*, Appellants contend that he still erred in holding such "setoffs" contrary to federal law and unenforceable, when the bankruptcy

case of *In Re Ambulance Corporation of America*, 27 B.R. 910 (Bankr. E.D. Penn 1983) held that post-petition setoff of prepetition Medicare overpayments against currently due Medicare reimbursement to a debtor in bankruptcy *was consistent with bankruptcy law* until a bankruptcy court order *after adequate protection of the government's interest was entered. Ambulance, supra* at 912.*

It is undisputed that in *Willington* no bankruptcy order of adequate assurance to Appellants' interest was ever entered.

* * *

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* The *Ambulance* Court expressly held: "It is undisputed the Defendants are authorized to setoff past overpayments against reimbursements currently due under the Medicare program . . . This right of setoff is preserved under the Bankruptcy Code. 11 U.S.C. § 553. A party with a right of setoff may retain funds until the issue of the propriety of setoff is decided. 11 U.S.C. § 542(b).

Under the Bankruptcy Code, a right of setoff is treated as a secured claim. 11 U.S.C. § 506(a). Furthermore, the debtor's right to reimbursement constitutes "cash collateral" under the Code. 11 U.S.C. § 363(a). Although these funds, if reimbursed, are collateral of a nature which could be used by the debtor,[3] cash collateral may not be used by the debtor unless there is consent of the secured party or pursuant to a court order. 11 U.S.C. § 362(c)(2). If the Court were to permit the debtor to use this cash collateral, the interest of the Defendants would have to be adequately protected. 11 U.S.C. § 363(e)." *Ambulance, supra* at 911-912.

*** authority for the specific fact pattern and procedural posture of the *Willington* adversary proceeding here on appeal, i.e., a 28 U.S.C. § 1471(b) "related to" adversary proceeding seeking past contractual money damages from state agencies.

If the *entirety* of 11 U.S.C. § 106, its legislative history and case law are to have consistent and harmonious meaning, then on this specific fact pattern and procedural posture, Connecticut's Sovereign Immunity is a jurisdictional defense to the *Willington* adversary proceeding at bar.

IV. THE STATE MEDICAID AGENCY'S RIGHT TO RECOUP PAST MEDICAID OVERPAYMENTS FROM THE MONTHLY MEDICAID PAYMENT CHECKS TO A NURSING HOME DEBTOR.

A. FACTUAL MISUNDERSTANDING OF MEDICAID RATE LAW BY APPELLEE AND JUDGE KRECHEVSKY.

Both Appellee and Judge Krechevsky viewed this issue as an everyday run of the mill creditor-debtor dispute where the latter has filed in bankruptcy and therefore refused to follow the five (5) bankruptcy decisions specifically governing this issue.

Without reiterating Appellants factual and legal statement of the Medicaid Cost Related Reimbursement System (which are undisputed in this case), one major example of the factual misunderstanding of the Medicaid Program by both Appellee and Judge Krechevsky should be raised.

For while neither one questions the fact that the per diem rate of a nursing home is computed by the State taking the nursing home's word for whatever costs it claims, both would invoke the bankruptcy automatic stay to stop field auditing to verify these cost claims and recoupment of monies illegally

received* and would further argue that the State must pay the debtor the "reasonable value" of services it renders.

But, given the fact that each nursing home *has its own individual Medicaid rate* based upon the costs it claims, what is the "reasonable value?" The Trustee wants to multiply the number of patient days times the nursing home's Medicaid rate. But under his view that the bankruptcy automatic stay stops field auditing and recoupment, that rate would include the unallowable costs and be inflated and perhaps fraudulent. That's "reasonable value?" No, it is not. Whether the Trustee realizes this or not, if his theory prevails the Bankruptcy Code would be misused to aid and abet Medicaid fraud (as providers could fill their annual reports with unallowable cost claims, collect resultant increased Medicaid rates and just file in Chapter 11 when the State's field auditors appear).

B. APPELLEE'S ATTEMPT TO DISTINGUISH THE BANKRUPTCY CASE LAW AUTHORITY UPHOLDING THE STATE MEDICAID AGENCY'S RIGHT OF RECOUPMENT IS WITHOUT MERIT.

While the Appellee is correct in pointing out that in the *Monsour* case there was formal assumption of the provider agreement (Appellee's Appeal Brief at p. 15), the *Yonkers* case expressly rejected that distinction where the health care facility continues with the provider agreement after filing in bankruptcy (see Appellants' Appeal Brief at p. 51–52).

Indeed, the *Yonkers* fact pattern was virtually identical to the *Willington* fact pattern in the case at bar. Both providers had received past Medicare/Medicaid overpayments from the government (discovered by field audits); both providers filed in Chapter 11 and had modest monthly recoupment of said debts from their periodic payment checks; and both debtors subsequently converted to Chapter 7 and had their trustees sue the government over said recoupments. See

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* Absent formal assumption of the provider agreement.

22 B.R. at 429. Contrary to Appellee's statements at p. 15-16 of his Appeal Brief, the *Willington* debtor also was aware of and acquiesced in the post-petition recoupment* as evidenced by the undisputed fact that it was only after to conversion of the Willington case from Chapter 11 to Chapter 7 and the appointment of Mr. Hoffman as trustee that any adversary proceeding against Appellants was initiated.

Other than said futile attempt to distinguish *Monsour* and *Yonkers*, Appellee stands silent on the merits of the holdings of the two (2) *Monsour* decisions, *Berger*, *Yonkers* and *Ambulance* (See Appellants' Appeal Brief at p. 50-53), which authorize the recoupment at issue here.

C. NOTWITHSTANDING *BILDISCO*, *YONKERS* REMAINS THE APPLICABLE BANKRUPTCY CASE LAW AUTHORITY WHERE A NURSING HOME DEBTOR ELECTS TO CONTINUE POST-PETITION PARTICIPATION IN THE MEDICAID PROGRAM.

Appellants stand on p. 53-55 of their Appeal Brief. *Bildisco* is a factually distinguishable non-Medicare/Medicaid bankruptcy case. *Yonkers* continues to be the Medicare/Medicaid bankruptcy authority.

In the alternative, even *Bildisco*, as applied to circumstances such as in *Willington* would have to view "reasonable value" as "what is specified in the contract" (i.e., to include field auditing and recoupment to insure that the rates paid were in fact for patient care and were not illegally diverted. Otherwise there would be no mechanism whatsoever to determine what constitutes "reasonable value."

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* For example, in August of 1982, pursuant to an oral agreement with the *Willington* debtor, the amount of monthly recoupment was substantially reduced.

D. APPELLANTS' REPAYMENT RIGHT IS IN RECOUPMENT, NOT SETOFF, SINCE RECOUPMENT OF PAST MEDICAID OVERPAYMENTS ARISING OUT OF THE SAME TRANSACTION — THE NURSING HOME/MEDICAID AGENCY ONGOING RELATIONSHIP.

In his Appeal Brief at p. 14 all the Trustee did was to refer only to the authority cited by Judge Schwartzberg in *Yonkers* on this issue (22 B.R. at 432, 433) and by Appellants at p. 56 of their Appeal Brief *and then reverse the legal conclusion.*

Appellants believe that Judge Schuartzberg correctly ruled that the government's statutory and regulatory authority to recoup past Medicard overpayments "codify the government's common law right of recoupment," *Yonkers*, 22 B.R. at 433, and that such recoupment is "merely an arrival at a just and proper liability on the main issue" arising out of the same transaction (i.e., the health care provider — Medicare/Medicaid agency ongoing contractual relationship). 4 *Collier on Bankruptcy*, ¶ 553.03 at p. 553-12 *as quoted in Yonkers*, 22 B.R. at 432, 433.

It has been previously established and affirmed that a series of Medicare provider agreements *constitute one, ongoing executory contract. Monsour*, 8 B.R. at 613, *aff'd.* 11 B.R. at 1017.

Settled bankruptcy law on this issue contradicts both Judge Krechevsky and the Trustee.

E. REGARDLESS OF *BILDISCO* AND THE RECOUPMENT VERSUS SETOFF ISSUE, JUDGE KRECHEVSKY STILL ERRED IN HOLDING APPELLANTS' "SETOFFS" CONTRARY TO BANKRUPTCY LAW.

At p. 16-17 of his Appeal Brief, the Trustee irrelevantly argues the general rule of bankruptcy law, that prepetition debts may not be set off against postpetition claims.

Appellants do not argue that this is the general rule in non-Medicare/Medicaid continuing provider agreement situations.*

The Trustee's citation of Code § 553(a), Collier, *Hill* and *Energy Co-op* refer to said general rule and are irrelevant to the fact pattern at bar. The *Howell* case refers to a Chapter 13 debtor' disability benefits directly received from the Social Security Administration and is impacted by the legislative history of Code § 101(24) concerning such benefits. 4 B.R. at 106. The *Neavear* case also involves such Social Security disability benefits and is *wrongly cited* by the Appellee as concerning past Medicaid overpayments. Finally, the very proposition for which the Trustee cites *Dartmouth* (a state's claim to past Medicaid overpayments has the characteristics of an antecedent unsecured claim) was subsequently expressly rejected by the *Ambulance* bankruptcy court ("This Court, however, is not persuaded by the reasoning expressed therein. *We do not believe that the relationship between the parties in this case can be characterized merely as that of a debtor and an unsecured creditor.*" 27 B.R. at 912 (emphasis added).

• • •

But even assuming *arguendo* Judge Krechevsky's reading of *Bildisco* and his setoff instead of recoupment holding, he still erred in then holding such "setoffs" contrary to bankruptcy law and unenforceable. 27 B.R. at 912.

P. 56-57 of Appellants' Appeal Brief set forth with specificity a discussion of the *Ambulance* case and said bankruptcy court's statutory analysis of the Bankruptcy Code, concluding that postpetition setoff of prepetition Medicare overpayments against currently due Medicare reimbursement to a

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* As discussed at p. 50-53 of Appellants' Appeal Brief, five (5) of the six (6) bankruptcy decisions on this issue came down on the side of the recoupment right of the Medicare/Medicaid agency. The sixth case (*Dartmouth*) (cited by the Appellee at p. 17 of his Appeal Brief) was wrongly decided based on a major factual error and was subsequently rejected by the *Ambulance* Court.

debtor in bankruptcy *was consistent with bankruptcy law* until a bankruptcy court order *after adequate protection of the government's interest was entered.* 27 B.R. at 912.

It is undisputed that in *Willington* no such order of adequate protection to Appellants' interest was ever entered.

Appellee's total silence on this point is of great significance. Indeed, Judge Krechevsky's citation of *Ambulance* in his Memorandum and Order but failure to respond at all to this holding is also most noteworthy.

V. THE BANKRUPTCY COURT ERRED IN DENYING THE FAILURE TO EXHAUST ADMINISTRATIVE REMEDIES AND FULL FAITH AND CREDIT GROUNDS OF THE MOTION TO DISMISS.

In our Appeal Brief, Appellants called to the attention of the District Court that these (2) separate and independent jurisdictional grounds of the Motion to Dismiss were not contested by the Trustee and were denied by Judge Krechevsky with no legal basis for such denial presented in his Memorandum and Order.

Appellants contend in this appeal that this was arbitrary and capricious.

RELEVANT DOCKET ENTRIES
Edward Zera

1-05-84 Complaint filed by Trustee.

2-21-84 Defendant's Motion to Dismiss.

2-21-84 Memorandum In Support of Defendant's Motion to Dismiss.

4-26-84 Plaintiff's Memorandum in Opposition to Defendant's Motion to Dismiss.

5-09-84 Defendant's Reply Memorandum to Plaintiff's Memorandum In Opposition to Motion to Dismiss.

5-11-84 Parties' Consent to Entry of Judgment or Dispositive Order by a United States Bankruptcy Judge.

6-08-84 Memorandum & Order Denying Motion to Dismiss, MD sent copies to: Martin Hoffman, Esq., Jonathan Ensign, Esq.

6-15-84 Notice of Appeal by State of Ct., Dept. of Rev. Serv., Defendant, on Mem. & Order dated 6/8/84 Denying Motion to Dismiss.

6-20-84 Notice of Cross-Appeal by Martin W. Hoffman, Plaintiff.

7-30-84 Record on appeal (copies) received from Bankruptcy Office. Appeal is on Memorandum and Order of Bankruptcy Judge in which court denied Plaintiff's claim.

8-27-84 Brief of the Cross-Appellant filed, Martin Hoffman.

9-19-84 Brief of the Appellant and Cross-Appellee.

11-05-84 Brief of the Appellee and Cross-Appellant, filed.

11-13-84 Reply Brief of Appellant filed.

6-18-85 Certification Order Pursuant to 28 U.S.C. Sec. 2403(b) "Atty. General to report intervention on or by 7-19-85." Dorsey, J. — cc mld (LW).

9-27-85 Motion for Intervention of the United States fld (LW).

10-10-85 END on Dckt no. 13 "GRANTED." Dorsey, J. — cc mld (LW).

5-11-87 Memorandum of Decision (Accordingly, the order of the bankruptcy court dismissing Revenue's mot. to dismiss is reversed and the case is remanded to that court for the purpose of dismissing the action against Revenue.) Dorsey, J. — cc mld (LW) M. 5/12/87

6-04-87 Notice of Appeal from Order of Reversal. Fee paid. Civil Management Plan and Forms C & D handed to appellant's atty. Certified copy of notice and docket sheet mld to USCA; copies to counsel (CB).

6-08-87 Copy of district court docket entries and notice of appeal on behalf of the appellant Martin W. Hoffman, Trustee, filed.

10-09-87 Appellant Martin W. Hoffman, Trustee brief filed w/pfs.

10-09-87 Appellant Martin W. Hoffman, Trustee appendix filed w/pfs.

11-09-87 Appellee Connecticut Dept. of Income Maintenance (sic) briefs filed w/pfs.

11-13-87 Intervenor-Appellee USA brief filed (w/pfs).

11-23-87 Appellant Martin W. Hoffman, Trustee reply brief filed w/pfs.

1-27-88 Case heard before Oakes, Newman, Miner,, C.JJ.

6-15-88 Judgment Affirmed by published signed opinion per Judge Miner (original filed in 87-5021) Judgment Filed.

Chapter 7 Proceeding No. 2-83-00754
Adversary Proceeding No. 2-84-0008

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

EDWARD ZERA fdba
Debtor

MARTIN W. HOFFMAN, TRUSTEE
Plaintiff

v.

STATE OF CONNECTICUT,
DEPARTMENT OF REVENUE SERVICES
Defendant

COMPLAINT

(dated January 4, 1984)

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1. This is an action to set aside, pursuant to 11 U.S.C. Sec. 547, a preference made by the Debtor to the Defendant herein and to recover the value of said transfer for the benefit of the estate in accordance with 11 U.S.C. Section 550.

2. Jurisdiction is conferred on this Court by 11 U.S.C. Section 105 and 28 U.S.C. Section 1471.

3. On October 7, 1983, the above-named Debtor filed a Chapter 7 Proceeding, and on October 11, 1983, Martin W. Hoffman, Esq. was appointed Trustee of said Estate.

4. The Defendant, Department of Revenue Services, has an address of 92 Farmington Avenue, Hartford, CT.

5. Within 90 days of the filing of the petition seeking relief, the Defendant received payment from funds of the Debtor totaling $2,100.62.

6. Said transfer of $2,100.62 constitutes a voidable preference within the meaning of Section 547 of the Bankruptcy Code for the reasons that:

a. the transfer was to or for the benefit of Defendant who was a creditor of the debtor;

b. the transfer was for or on account of an antecedent debt owed by the Debtor before said transfer was made;

c. the transfer was made while the debtor was insolvent;

d. the transfer was made within 90 days before the date of the filing of the petition; and

e. the transfer enabled the creditor to receive more than any other creditor of the debtor.

7. Demand for the turnover of the funds has been made and refused.

WHEREFORE, Plaintiff demands judgment, setting aside the transfer as preferential and that judgment be entered in favor of the Plaintiff against the Defendant in the amount of Two Thousand One Hundred and 62/100 (2,100.62) Dollars and costs.

Dated at Hartford, Connecticut, this 4th day of January, 1984.

PLAINTIFF:
Martin W. Hoffman, Trustee

By /s/ Martin W. Hoffman

Martin W. Hoffman
Attorney for the Trustee
410 Asylum Street
Hartford, CT 06103

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

(Caption omitted in printing)

MOTION TO DISMISS

(February 21, 1984)

The defendant hereby moves the Court, pursuant to Rules 12(b)(1) and 12(b)(6) of the Federal Rules of Civil Procedure and Bankruptcy Rule 7012, 11 U.S.C., to dismiss this action for the following reasons:

1. The Complaint fails to demonstrate the jurisdiction of this Court in law or in fact.

2. The Complaint fails to state a claim upon which relief can be granted.

THE DEFENDANT

BY: JOSEPH I. LIEBERMAN
ATTORNEY GENERAL

/s/ Jonathan L. Ensign

Jonathan L. Ensign
Assistant Attorney General
P.O. Box 120
Hartford, CT 06101
Tel. (203) 566-4899

(Certificate of Service omitted in printing)

*** section 547(b), the Court of Appeals concluded that Congress intended for this action to be brought in federal court. *Id.* at 327.

Section 542(b) contains the word "entity", which also triggers section 106(c)'s waiver of sovereign immunity. Thus, the Plaintiff may assert a cause of action against the Defendant based on section 542(b) notwithstanding sovereign immunity. Congress granted the Bankruptcy Court jurisdiction over an action under section 542(b) when it enacted 28 U.S.C. § 1471. Therefore, Congress clearly abrogated the Defendant's Eleventh Amendment immunity with respect to the Plaintiff's suit.

IV. WHETHER 11 U.S.C. § 553 PRECLUDES THE DEFENDANTS FROM SETTING OFF THE POST-PETITION DEBT IT OWES TO THE ESTATE AGAINST ITS PREPETITION CLAIM

A. The Defendant's claim is one in setoff, not recoupment, since the claim arises from a different transaction than the Plaintiff's cause of action.

The District Court erroneously held that the State of Connecticut had the right to recoup prepetition overpayments made to the Debtor by withholding funds for services performed by the Debtor post-petition. *Willington*, 72 B.R. at 1012. The State of Connecticut, however, has only a right to setoff under its contract with the Debtor, not a right of recoupment.

The distinction between recoupment and setoff is crucial in a bankruptcy context. A creditor's right to setoff under the Bankruptcy Code applies only to mutual debts incurred by debtor and creditor before the commencement of a case under

the Code. See 11 U.S.C. § 553(a).[5] There is no Code provision expressly governing recoupment, however.

The key distinction between recoupment and setoff is that the former arises from the same transaction as the plaintiff's claim and the latter from a distinct transaction. 4 *Collier on Bankruptcy*, § 553.03 at 553-12 (15th ed. 1984). In the instant case, the State seeks to recover alleged overpayments under Medicaid contracts for the years 1976-1980 against a debt owed to the Debtor arising from services provided after the Debtor filed under Chapter 11. As the Bankruptcy Court in this case noted the parties' respective claims "neither relate to the same subject matter nor arise from the same contract." *Willington*, 39 B.R. at 792. Hence, the State's claim must be characterized as one in setoff rather than recoupment.

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[5] 11 U.S.C. § 553(a) provides:

(a) Except as other provided in this section and in sections 362 and 263 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case, except to the extent that —

(1) the claim of such creditor against the debtor is disallowed other than under section 502(b)(3) of this title;

(2) such claim was transferred, by an entity other than the debtor, to such creditor —

(A) after the commencement of the case; or

(B) (i) after 90 days before the date of the filing of the petition; and (ii) while the debtor was insolvent; or

(3) the debt owed to the debtor by such creditor

(A) after 90 days before the date of the filing of the petition;

(B) while the debtor was insolvent; and

(C) for the purpose of obtaining a right of setoff against the debtor.

11 U.S.C. § 553 (1987).

B. Since under the Bankruptcy Code a creditor may not set off a post-petition claim or debt owed to the estate against a pre-petition claim or debt owed to the estate, any sum that might be owing to the State for alleged Medicaid overpayments has the status of an antecedent unsecured debt.

11 U.S.C. § 553(a), governing a creditor's right to setoff against a debtor does not apply where a creditor attempts to set off a pre-petition debt or claim against a debt or claim of the estate arising after the filing of a bankruptcy petition. 4 *Collier on Bankruptcy* § 553.10(1) at 553-49 (15th ed. 1984).

The reason that the right of setoff under the Bankruptcy Code is limited to transactions arising before the commencement of a bankruptcy case is to preserve the element of mutuality of obligation. 4 *Collier* at 553.10(1). To permit creditors to offset pre-petition debts from post-petition obligations would be to allow them to unilaterally deplete the resources available to the debtor to satisfy all creditors. *In Re Hill*, 9 B.C.D. 53 at 55 (Bankr. N.D. Tex. 1982); *In Re Energy Co-Op, Inc.*, 32 B.R. 680 at 684 (Bankr. N.D. Ill. 1983). It is clear that payments due to a debtor-in-possession under an executory contract are property of the estate. *In Re Howell*, 7 B.C.D. 1 at 3 (Bankr. M.D. Tenn. 1980). Whatever claim the Defendants may assert to alleged past Medicaid overpayments has the characteristics of an antecedent unsecured debt. *In Re Dartmouth House Nursing Home*, 9 B.C.D. 954 at 956 (Bankr. Mass. 1982); *In Re Nevear*, 9 B.C.D. 132 (7th Cir. 1982). Of course, a full determination of the status of the Defendant's claim awaits the Bankruptcy Court's review of the merits of the instant case.

C. Whether the provider agreements between the Debtor and the State are considered separate agreements of a single executory contract, they are unenforceable against the Debtor.

As the Bankruptcy Court noted in its Memorandum and Order, even if the past Medicaid provider agreements between

the Defendants and the Debtor are considered part of a single executory contract, they are unenforceable against the Debtor absent their formal assumption by the Debtor. *Willington*, 39 B.R. at 791. In *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 104 S.Ct. 1188, 79 L.Ed.2d 482 (1984), Justice Rehnquist found that an employer was not bound to comply with the terms of an executory collective bargaining agreement after the commencement of Chapter 11 proceedings but before formal assumption or rejection of the contract, "since the filing of a petition in bankruptcy under Chapter 11 makes the contract unenforceable." 104 S.Ct. at 1200.

Bildisco does not hold for the proposition that a debtor-in-possession may accept the benefits of a contract without incurring corresponding obligations. Pending formal assumption or rejection of the contract, the debtor is "obligated to pay for the reasonable value" of services rendered to it by the other parties to the agreement. 104 S.Ct. at 1199. In the instant case, the Debtor fulfilled its part of the bargain by performing the services required of it under the Medicaid provider agreement. It is the Defendants who have denied the Debtor compensation for the reasonable value of its services, and who claim that the Debtor should further be denied a right of action to recover that compensation.

(Pages 6–13 of Connecticut's Brief of the Defendants-Appellees dated November 6, 1987)

*** preceeding month), in part recovering the $10,000.00 extraordinary post-petition advance.

Although Willington still owed the State $121,408.82 in past Medicaid overpayments, the Department of Income Maintenance did not file any proof of claim in the Willington bankruptcy case as the agency scrupulously avoided doing anything that could be argued to waive either its Sovereign Immunity or its Eleventh Amendment Immunity.

On July 27, 1983, the Bankruptcy Court converted the Willington bankruptcy case from Chapter 11 to Chapter 7 and appointed a Trustee. The Trustee on January 3, 1984 filed a Complaint for Money Damages Adversary Proceeding against the State under the 28 U.S.C. § 1471(b) "related" jurisdiction. Contrary to the Trustee's brief, it was *not* a turnover petition pursuant to 11 U.S.C. § 542(b). The only relief sought was past contractual money damages from a state agency in a federal court. (Appendix, hereinafter "App.", p. A-6).

The State concurs with the Trustee's recitation of the subsequent procedural sequence of events which took place in the bankruptcy and district courts, which culminated in the District Court granting the State's Motion to Dismiss.

ARGUMENT

I. THE BANKRUPTCY LAW DOCTRINE OF RECOUPMENT ENTITLED THE STATE MEDICAID AGENCY TO RECOUP PAST MEDICAID OVERPAYMENTS DETECTED BY THE FIELD AUDIT OF DEBTOR NURSING HOME'S COST CLAIMS.

A. The Factual Findings of the District Court and Connecticut State Law Establish That the Doctrine of Recoupment Governs in this Case Because the Nursing Home Submission of Cost Claims to the State Medicaid Agency and the Field Auditing of Same Constitute One Transaction.

The District Court entered specific factual findings at App., p. A-84 to A-86 and A-103 that:

1. The debtor nursing home voluntarily contracted with the State to participate in the Connecticut Medicaid Program (App., p. A-84);

2. That the contract provided for computation of the annual per diem rate of payment on the basis that Willington would submit cost data which the State would accept at face value *subject to* subsequent field audits to verify that the costs claimed are legitimate (App., p. A-84);

3. That the contract further provided that if costs are found to have been improperly claimed, the State would adjust the per diem rate retroactive to the applicable rate year *and recoup the amount of Medicaid overpayment from whatever monthly payments may be due and owing to the facility for current patient care* (App., p. A-84);

4. That a field audit of Willington's cost reports discovered that the debtor had falsely claimed real property costs of $294,007 which were only allowable in the amount of $22,500 (App., p. A-85); and

5. That the contract between Willington and the State entitled Connecticut to recoup past Medicaid overpayments to Willington for services rendered after filing in bankruptcy (App., p. A-103).

Thus, the District Court made factual findings that the debtor and the State contracted on the basis that the final correct per diem rate of payment would only be determined post-field audit. Further, both Connecticut State law[10] and the contract itself specifically provided for "recoupment" when a field audit detected past false cost claims and resulting overpayments. Thus, when Willington and the State entered into their contractual relationship, both parties intended recoupment to govern in the Medicaid rate computation and verification process. They further intended that the filing of cost claims and the verification of same was part and parcel of one single transaction.

That the relationship between Willington and the State Medicaid agency was one continuous transaction is further established by Conn. Gen. Stat. § 19a-154, which requires that the State grant permission for a nursing home to leave the Connecticut Medicaid Program.

B. Case Law on Recoupment Versus Setoff

Without even reaching the numerous and complex issues *infra* involving the interrelationship of the Eleventh Amendment, Sovereign Immunity and the Bankruptcy Code, the District Court can and should be easily affirmed on its alternative holding "that the terms of Willington's contract with Connecticut entitled the state to recoup past overpayments to Willington . . ." App., p. A-103.[11]

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[10]Regulations of Connecticut State Agencies § 17-311-53.

[11]Rather than discuss the applicable law on this issue, the District Court incorporated by reference the Brief and Reply Brief which Connecticut had submitted to the District Court. App., p. A-103. In the event that the Second Circuit deems it helpful to review said pages, they are at S.App., p. SA-8 to SA-26.

When this issue was briefed for the District Court in 1984, four of the five bankruptcy cases then in existence held in favor of the right of the Medicare/Medicaid agency to recoup overpayments from providers notwithstanding their filing in bankruptcy. *In Re Monsour Medical Center*, 8 B.R. 606 (Bankr. W.D. Pa. 1981), *aff'd* 11 B.R. 1014 (W.D. Pa. 1981); *In Re Berger*, 16 B.R. 236 (Bankr. S.D. Fla. 1981); *In Re Yonkers Hamilton Sanitarium, Inc.*, 22 B.R. 427 (Bankr. S.D.N.Y. 1982), *aff'd* 34 B.R. 385 (S.D.N.Y. 1983); *In Re Ambulance Corporation of America*, 27 B.R. 910 (Bankr. E.D. Pa. 1983). *Contra: In Re Dartmouth House Nursing Home, Inc.*, 24 B.R. 256 (Bankr. Mass. 1982)[12]

Bankruptcy case law on this issue has since developed further to include recognition by both the Third and Tenth Circuits of the government's overpayment recoupment right against health care providers notwithstanding bankruptcy. See *Lee v. Schweiker*, 739 F.2d 870, 875–876 (3rd Cir. 1984); *In Re B & L Oil Co.*, 782 F.2d 155, 157 (10th Cir. 1986).

In *Lee v. Schweiker, supra*, the Third Circuit discussed the doctrines of "setoff" and "recoupment," which doctrines have been both adopted in bankruptcy, setoff by statute and recoupment by decision. 739 F.2d at 875.[13] While "setoff" is limited to mutual, pre-petition claims against the creditor and is further limited by 11 U.S.C. § 553 (e.g., pre-petition claims against the debtor cannot be setoff against post-petition debts to the debtor),[14] "[r]ecoupment, on the other hand, allows the

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[12]The *Dartmouth* case was both wrongly decided (rejected by *Ambulance*, 27 B.R. at 912) and distinguishable due to the difficult rate system employed by Massachusetts which did in fact provide for rate setting *and* verification *in the same year*. See 24 B.R. at 258.

[13]See also *B & L Oil Co.*, 782 F.2d at 157; *In Re Nickerson & Nickerson, Inc.*, 62 B.R. 83, 87 (Bankr. D.Neb. 1986); *In Re American Cent. Airlines, Inc.*, 60 B.R. 587, 590 (Bankr. N.D. Iowa 1986).

[14]But even re "setoff", see *Ambulance*, 27 B.R. at 912 (Medicare-Medicaid agency can "setoff" pre-petition overpayment against a post-petition payment absent court order or adequate protection of the government).

creditor to assert that certain mutual claims extinguish one another in bankruptcy, in spite of the fact that they could not be 'setoff' under 11 U.S.C. § 553. The justification for the recoupment doctrine is that where the creditor's claim against the debtor arises from the same transaction as the debtor's claim, it is essentially a defense to the debtor's claim against the creditor rather than a mutual obligation, and the application of the limitations on setoff in bankruptcy would be inequitable. [citation omitted]." 739 F.2d at 875.[15]

The Third Circuit then specifically observed:

> "In bankruptcy, the recoupment doctrine has been applied primarily where the creditor's claim against the debtor and the debtor's claim against the creditor arise out of the same contract [citations omitted]. *In a number of cases involving the bankruptcy of health-care providers, the courts have allowed . . . [Medicare fiscal intermediaries] to 'recoup' overpayments from amounts owed to the debtor post-petition, under a contract providing for such recoupment* [citing *Monsour, Yonkers* and *Berger*] . . . The analysis used in these cases is based on the treatment of executory contracts in bankruptcy: *a debtor may not assume the favorable aspects of a contract (post-petition payments) and reject the unfavorable aspects of the same contract (the obligation to repay pre-petition overpayments by means of 'recoupment').*

The courts have generally taken a different approach in dealing with government benefits to individuals, such as social security. In these circumstances, the courts have held that a social-welfare statute entitling an individual to benefits is not a

[15] Indeed, it has been specifically held that the doctrine of recoupment is *not* subject to the setoff provisions of 11 U.S.C. § 553. *In Re Yonkers Hamilton Sanitarium, Inc., supra; In Re Alpco, Inc.*, 62 B.R. 184, 188 (Bankr. S.D. Ohio 1986).

> contract, and that the obligation to repay a previous overpayment is a separate debt subject to the ordinary rules of bankruptcy [citations omitted]. *We find the distinction persuasive.*" 739 F.2d at 875-876 (emphasis added).

Indeed, it has been held that where the doctrine of recoupment applies, "[t]here is no element of preference here or of an independent claim to be offset, but merely an arrival of a just and proper liability on the main issue, and this would seem permissible without any reference to . . . § 553(a)." *In Re McCoy*, 65 B.R. 673, 674 (Bankr. S.D. Ill. 1986) *citing 4 Collier on Bankruptcy*, ¶ 553.03 at 553.12 (15th Ed. 1981); *Yonkers, supra.*

See also *In Re American Cent. Airlines*, 60 B.R. at 590 (where the doctrine of recoupment governs, "the distinction between pre-petition and post-petition events does not apply"); *In Re Neuman*, 55 B.R. 702, 706 (S.D.N.Y. 1985) (with an excellent discussion of the government's comon law right to recoup Medicare overpayments from funds otherwise due to a health care provider codified both by statute and by regulation); *In Re Alpco, Inc.*, 62 B.R. at 187-188; *In Re Clowards*, 42 B.R. 627, 628 (Bankr. D. Idaho 1984).

C. Given Willington's Conduct in the Case, Equity Mandates Application of the Doctrine of Recoupment.

As the Tenth Circuit has observed, bankruptcy courts apply recoupment as an equitable doctrine to avoid unjust enrichment of the debtor or a windfall to his other creditors. *B & L Oil*, 782 F.2d at 159.

This appeal is a classic case of where equity mandates application of the doctrine of recoupment. For here, the debtor submitted false cost claims of $294,007 in historical property costs (actually only allowable in the amount of $22,500) and for five years illegally pocketed valuable scarce taxpayer dollars set aside for the care of indigent, medically needy, Title

XIX Medicaid patients. App., p. A-84. When caught by the auditors and its rates appropriately recomputed in 1982, the debtor promptly filed its operating corporation in bankruptcy to evade its recoupment obligation, App., p. A-86, but kept out of the bankruptcy the nursing home building and realty, which the debtor's owners sold and personally pocketed the proceeds.

The Trustee argues that "*[i]t is clear* that payments due to a debtor in possession under an executory contract are property of the estate." Brief 26 (emphasis added). It is, in fact, not clear. In *In Re American Cent. Airlines*, the bankruptcy court held that the "interest that the bankruptcy estate acquire[s] in the post-petition subsidy payments is subject to DOT's right to recoup." 60 B.R. at 592. It has been specifically held that Medicaid providers "have no vested property interest in retaining . . . [past Medicaid] overpayments." *St. Joseph Hospital v. Electronic Data Systems Corp.*, 573 F.Supp. 443, 447 (S.D. Tex. 1983).[16]

In any event, it is undisputed that, even after its filing in bankruptcy on June 2, 1982, Willington chose to continue its participation in the Connecticut Medicaid Program and continued to receive monthly Medicaid payment checks until it closed in April, 1983. App., p. A-86. Indeed, in August, 1982, Willington even negotiated an agreement with the State to reduce the monthly rate of recoupment.

Thus, even though Willington never submitted its provider agreement for either assumption or rejection, its above-discussed undisputed conduct constituted assumption of the executory contract. See *In Re Reda, Inc.*, 54 B.R. 871, 880, 881 (Bankr. N.D.Ill. 1985) (Although there was no formal

[16]The *St. Joseph* Court went on to note that "the funds at issue do not even 'belong' to the providers under any circumstances . . . The public interest factor strongly militates against the hospital's position since the public has a very strong interest in promptly recovering a debt . . . that has been due for several years. (One must bear in mind that the monies at issue here represent tax dollars)." 573 F.Supp. at 448-449.

assumption by the debtor, the court found that the debtor's actions constituted acceptance of the executory contract, holding that the debtor was responsible for the benefits and burdens of the contract); *In Re Midwest Services & Supply Co., Inc.*, 44 B.R. 262, 265 (D. Utah, C.D. 1983).

Indeed, Bankruptcy Judge Schwartzberg of the Southern District of New York has expressly rejected the argument that recoupment could not be effected because the provider agreement had neither been assumed nor rejected, holding:

> "It does not follow, however, that if neither party to an executory contract . . . takes any action with respect to assumption or rejection, the contract has no significance. As long as the debtor continues to receive benefits under such contract it must also bear the burdens or obligations imposed under the contract. [citations omitted]. the *Monsour* and *Berger* cases are consistent with this principle *and were not incorrectly decided*, as the Trustee's counsel contends. *Yonkers*, 22 B.R. at 435 (emphasis added).[17]

The Trustee relies on *N.L.R.B. v. Bildisco and Bildisco*, 465 U.S. 513, 104 S.Ct. 1188, 79 L.Ed.2d 482 (1984) for his argument that the Willington provider agreement was unenforceable because it was not assumed. However, in *Bildisco there was no recoupment issue at all*,[18] and the debtor there gave notice by its conduct of its unwillingness or inability to comply with its collective bargaining agreement and then

[17]On appeal, the *Yonkers* district court affirmed, stressing the inequity which would result if the provider could evade the burden of recoupment of past overpayments after having accepted the benefit of the executory contract (provider agreement) in the form of continued Medicare funding. 34 B.R. at 388.

[18]Because, as demonstrated *supra*, the doctrine of recoupment, where applicable, is part of federal bankruptcy law, it is irrelevant whether or not the contract was assumed or rejected. In any event, as demonstrated *supra*, the *Willington* debtor by its conduct after filing in bankruptcy assumed its provider agreement.

actually moved and obtained the permission of the bankruptcy court to reject that agreement. 104 S.Ct. at 1192.

While the *Bildisco* Court noted that a Chapter 11 debtor has "more latitude *in deciding* whether to reject a contract . . ." *Bildisco*, 104 S.Ct. at 1198. (emphasis added), in *Willington* the nursing home debtor *never decided* to reject and by its day-to-day conduct indicated just the opposite.

However, as the Trustee has admitted:

> "*Bildisco* does not hold for the proposition that a debtor-in-possession may accept the benefits of a contract without incurring corresponding obligations. Pending formal assumption or rejection of the contract, the debtor is 'obligated to pay for the reasonable value' of services rendered to it by the other parties to the agreement. 104 S.Ct. at 1199." Brief 27.

This is significant because the provider agreement between Willington and the State defined "reasonable value" as the allowable costs actually expended and devoted to patient care as per the Connecticut Medicaid Cost Related Reimbursement System regulations. (i.e., *after* verification by the field audit).

Thus, even the *Bildisco* Court itself would insist that Willington receive not a penny more than the reasonable value of the contractual services rendered, i.e., the cost claims in Willington's annual cost reports *after* implementation of the field audit. Otherwise, the contract would be violated, the debtor or its other creditors unjustly enriched, and payment in excess of "reasonable value" would take place.

The other Connecticut bankruptcy judge has declared that the "definition of debt must . . . be read in the context of . . . [the legislative] policy" that "the bankruptcy laws are not a haven for criminal offenders, but are designed to give relief from financial over-extension." *In Re Pellegrino*, 42 B.R. 129, 134 (Bankr. D.Conn. 1984).

In *Willington*, the debtor's owners falsified cost claims in order to gain illegally money for themselves. The doctrine of recoupment is an equitable doctrine which allows the courts to protect innocent state Medicaid agencies victimized by false cost claims by health care providers in the same transaction pursuant to which the recoupment takes place, and such doctrine is most applicable to the fact pattern here as the district court correctly held.

Docket Nos. 87-5021, 87-5023

UNITED STATES COURT OF APPEALS
for the
SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the fifteenth day of June one thousand nine hundred and eighty-eight.

Present: Hon. James L. Oakes
Hon. Jon O. Newman
Hon. Roger J. Miner
Circuit Judges

IN RE: WILLINGTON CONVALESCENT HOME, INC.
Debtor

MARTIN W. HOFFMAN, TRUSTEE
Plaintiff-Appellant,

— against —

STATE OF CONNECTICUT,
DEPARTMENT OF INCOME MAINTENANCE
AND STATE OF CONNECTICUT,
DEPARTMENT OF HEALTH SERVICES,
Defendants-Appellees,

UNITED STATES OF AMERICA,
Intervenor-Appellee

IN RE: EDWARD ZERA,
Debtor

MARTIN W. HOFFMAN, TRUSTEE
Plaintiff-Appellant,

— against —

STATE OF CONNECTICUT,
DEPARTMENT OF REVENUE SERVICES
Defendant-Appellee,

UNITED STATES OF AMERICA,
Intervenor-Appellee

Appeal from the United States District Court for the District of Connecticut.

This cause came on to be heard on the transcript of record from the United States District Court for the District of Connecticut, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed in accordance with the opinion of this court with costs to be taxed against the appellant.

ELAINE B. GOLDSMITH, Clerk
/s/ Edward J. Guardaro
By: Edward J. Guardaro
Deputy Clerk

Supreme Court, U.S.
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CLERK

No. 88-412

In The
Supreme Court Of The United States

OCTOBER TERM, 1988

MARTIN W. HOFFMAN, TRUSTEE
Petitioner

v.

CONNECTICUT DEPARTMENT OF INCOME MAINTENANCE, ET AL.
Respondents

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

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QUESTIONS PRESENTED FOR REVIEW

I. Whether 11 U.S.C. § 106(c) authorizes a trustee in bankruptcy to recover a money judgment against a State when the State has not voluntarily waived sovereign immunity.

II. Whether Congress, in enacting 11 U.S.C. § 106(c), 28 U.S.C. §§ 157(a) and 1334(b), abrogated a State's Eleventh Amendment immunity to suit in federal court by a trustee in bankrupcty.

PARTIES BELOW

The parties before the United States Court of Appeals for the Second Circuit in *In re Willington Convalescent Home, Inc.*, were Martin W. Hoffman, Trustee, as Plaintiff-Appellant, State of Connecticut, Department of Income Maintenance and State of Connecticut, Department of Health Services as Defendant-Appellees and the United States of America as Intervenor-Appellee.*

The parties before the United States Court of Appeals for the Second Circuit in *In re Edward Zera* were Martin W. Hoffman, Trustee as Plaintiff-Appellant, State of Connecticut, Department of Revenue Services, as Defendant-Appellee and the United States of America as Intervenor-Appellee.

* Willington Convalescent Home, Inc. has no parent company, subsidiaries or affiliates.

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The opinion of the United States Court of Appeals for the Second Circuit is reported at 850 F.2d 50 (2nd Cir. 1988) and appears in the appendix to the Petition for Writ of Certiorari at pages A1-A19 (hereinafter "Pet. App.").

The opinion of the United States District Court for the District of Connecticut in *In re Willington Convalescent Home, Inc.* is reported at 72 B.R. 1002 (D. Conn. 1987) and appears in the Pet. App. at A20-A71. The opinion of said Court in *In re Edward Zera* is reported at 72 B.R. 997 (D. Conn. 1987) and appears in the Pet. App. at pages A72-A97.